Final Report

The Likely Impacts of Rent De-control on District of Columbia Residents

SUBMITTED TO
District of Columbia Financial Responsibility and Management Assistance Authority

SUBMITTED BY
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UNDER
DCFRA #99-C-010

June 19, 2000

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Preface

In February 1999, the District of Columbia Financial Responsibility and Management Assistance Authority (the Authority) contracted with Nathan Associates Inc. to conduct a study of the likely social and economic impacts of rent de-control on the residents of the District of Columbia. This study grew out of the recommendations of an earlier federally mandated study of potential regulatory reforms for the District of Columbia conducted by Holland & Knight, *et al*. The Holland & Knight study, *Mapping the Steps Toward Economic Revitalization,* recommended that the Authority consider eliminating or substantially reducing the requirements of the rent stabilization provisions of the District's Rental Housing Act for providers of rental housing.

Because rent control, effective in the District of Columbia since 1975, is a controversial issue that affects many District residents, particularly low- and moderate-income residents, the Holland & Knight study recommended that suggested reforms be postponed until after a study of the impact of eliminating rent stabilization was completed.

As defined by Holland & Knight, the study of the impact of eliminating rent stabilization is to determine

1. The anticipated reduction, if any, in the District's existing supply of affordable housing for low- and moderate-income residents if rent control is phased out.
2. The likely rent increases and changes in services and facilities, if any, that District tenants will experience as a result of rent de-control.
3. The expected increase, if any, in development and rehabilitation of affordable housing in the District for low- and moderate-income residents as a result of rent de-control.

The study also examines the impact that rent de-control has had on low- and moderate-income tenants in other cities, such as Boston.

To evaluate the preceding impacts required a comprehensive analysis of the current status and recent developments in the District's rental housing market. The findings of our research and analysis are presented in this report. The study was carried out by first determining the likely direct and immediate impacts of rent de-control on tenants (rent increases), and then by assessing the likely responses of rental housing providers to the changes in rents and the repeal of the rent stabilization provision in the District's Rental Housing Act. Benchmarking of the impacts of rent de-control in the

District to experiences in other formerly rent controlled markets was accomplished through a comprehensive literature search and review. Possible strategies that may be applied to end the District's rent control program in the event that decision is reached are outlined in a separate appendix.

The principal contributors to this final report are Stephen A. Schneider, Project Manager; Paul Bourquin, Senior Analyst; Stephen Malpezzi, Principal Consultant; and Lisa Johnson, Junior Analyst. Other Nathan Associates staff and consultants who made important contributions in the collection and analysis of the data for this study include Mark Glueck, David Sharp, Lisa Giddings, Pamela Kurtz, Andre Neveu, Aditi Mirani, and Rhea Austin.

1. Introduction and Summary

Rent regulation in Washington, D.C., has come under increasing scrutiny since the economic decline of the District at the start of the 1990s. Studies by Holland & Knight[1] and the D.C. Business and Regulatory Reform Commission recommended repealing the District's rent control legislation and regulations as one way of improving the District's regulatory and economic development environment. Revisiting the likely effects of de-control is timely since the legislation that authorized extension of the Rental Housing Act of 1985 expires on December 31, 2000.

The District of Columbia Financial Responsibility and Management Assistance Authority (DCFRA or "the Authority") retained Nathan Associates Inc. to evaluate how ending rent stabilization would affect low- and moderate-income tenants of rent stabilized dwellings and the availability of affordable housing for such tenants. Subsequently, the Authority requested that Nathan Associates Inc. outline the possible strategies that may be utilized to end the District's rent control program in the event that decision is reached.

Nathan Associates concludes that the elimination of the rent stabilization in the District of Columbia will have modest, if not *de minimis* effects, on District residents that make up the demand for affordable rental housing. Our conclusion is based on the nature and mechanics of the District's rent stabilization program, the current state of the rental housing market in the District, the results of a statistical model developed to predict D.C. rents in the absence of rent stabilization, and a survey of the likely responses of landlords and developers to the elimination of rent stabilization. Furthermore, Nathan Associates recommends that if the decision is made to end rent control in the District of Columbia, the means to achieve that end should be the blanket lifting of rent control with advanced notice.

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[1] Holland & Knight, *et al.*

Background

In this section, we review the history of rent control in the District since the 1970s, summarize the Urban Institutes' study of rent control in the District in the late 1980s, and explain the basic mechanics of the rent control regime, including how landlords may increase the maximum allowable rent charged for a rental unit and how local rent control regulations have changed over time. We then discuss the regulatory reform efforts of the Authority since the mid-1990s, and the findings and conclusions of the Holland & Knight study on how the District's regulations, including rent control, should be changed.

Rent Control in Washington, D.C.

The District's rent control program is a *second generation* program, similar to those in New Jersey, Connecticut, California, and Massachusetts, and implemented in more than 200 communities. These programs were authorized in response to the rapid inflation of the 1970s.[2] *First generation* rent controls were implemented by several communities during World War I, and then nationally during World War II, in response to wartime shortages of housing units and building materials. Second generation rent controls do not fix rents *per se*, but place limits on rent increases. Under these programs, rents may increase each year by a percentage that reflects the rate of increase in operating costs. Many programs allow for a larger rent adjustment when units are vacant, and some allow rents to be adjusted fully to market rents on tenant turnover. Newly constructed residential dwellings are exempt from controls, and landlords can raise rents to cover the costs of building improvements. Hardship provisions allow landlords to petition for relief in cases of extraordinary cost increases or unacceptably low rates of return.

In 1973, shortly after federal price controls put in place by the Nixon Administration expired, Congress authorized the District government to implement rent control legislation. By 1975, the D.C. City Council enacted legislation and promulgated regulations restricting rents on residential properties.[3] The Rental Housing Act of 1985 (D.C. Law 6-10, D.C. Code §45-2501, *et. seq.*) and corresponding regulations (DCMR Title 14, Chapters 38 *et. seq.*) are the successors to the initial rent control program. The rent control provisions of this law and its predecessors are intended to remedy a

[2] Rent control programs in Massachusetts and in four California communities have been recently repealed. See Chapter 3.

[3] The District's initial rent control law was the Rental Accommodations Act of 1975 (D.C. Law 1-33).

"severe shortage" of rental housing in the District. According to the law, this shortage arose from a host of factors, including the withdrawal of rental units from the market, the deterioration of existing units, the lack of rehabilitation of existing housing, and the lack of construction of new housing. The law also recognized that low- and moderate-income renters experienced the shortage most acutely.

Title II of the Rental Housing Act established the District of Columbia Rent Stabilization Program, commonly referred to as the Rent Control Program. Under Title II, a ceiling is imposed on the rents that can be charged on all nonexempt rental housing units. Exempt units are those (1) subject to federally or District-subsidized rents or mortgages; (2) newly constructed or substantially rehabilitated under building permits issued after December 31, 1975; (3) owned by landlords who own less than five rental units in the District; and (4) in buildings that had been continuously vacant since 1985. Title II and its implementing regulations set forth procedures for registering exempt and nonexempt rental units, for adjusting monthly rents and rent ceilings, and for petitioning for rent ceiling increases based on a number of circumstances.

Like other second generation rent control programs, rents under the D.C. program are not fixed, but increases are regulated. Rent ceilings can increase annually by the change in the Consumer Price Index (CPI) from the preceding year (up to a maximum annual increase of 10 percent) for units that are licensed, registered, and in compliance with the D.C. housing code. Rent ceilings can be raised by 12 percent or up to the ceiling for a comparable unit in the same property, whichever is higher, when a tenant vacates a unit. Landlords can petition to increase rent ceilings to reflect (1) the cost increases associated with capital improvements or substantial rehabilitation to the property, (2) for changes in services and facilities available at the property, and (3) for financial hardship, in which case rent ceiling increases can be approved to generate a 12 percent cash return on equity. Landlords can also negotiate voluntary agreements with their tenants to increase rent ceilings.[4]

Other portions of the Rental Housing Act relate to various aspects and features of all rental housing in the District, not just properties and units covered by the rent stabilization provisions. For example, Title IV of the Rental Housing Act, the Landlord-Tenant Law, sets out landlord-tenant policies in the form of legislated tenant eviction procedures, and includes legal remedies for both landlords and tenants. The Tenant Assistance Program (TAP), a rent subsidy program for lower-

[4] Title II of the 1985 Act has been amended several times. These include the Capital Improvements Amendment Act of 1989, the Elderly and Disabled Tenant Rental Housing Improvement Relief Amendment Act of 1992, and the Unitary Rent Ceiling Adjustment Act of 1992.

income city residents in privately owned apartment buildings, is similar to the federal Section 8 certificate program, but has not been funded for several years. Title III of the original 1975 Rental Accommodations Act concerned the sale and conversion of rental property into condominiums, a transaction that is now the subject of stand-alone legislation.[5]

Section 220 of the Rental Housing Act mandated a comprehensive study of rent control in the District to provide a factual basis for continuing rent stabilization. The District's Department of Consumer and Regulatory Affairs (DCRA) contracted with The Urban Institute (UI) to conduct the study. The Urban Institute reported its findings and conclusions in October 1988.[6] The scope of the study defined by the D.C. Council provided for estimates of the current (at the time) and future supply of rental housing, an assessment of TAP, and an evaluation of housing code enforcement in the District. The Urban Institute was also asked to evaluate the impact of rent control on the cost and supply of rental housing, among a number of other important issues.[7]

The Urban Institute found that rent control in the District kept rents lower than they would have been otherwise. The UI estimated that, in 1987, the monthly rent for the average unit would be from $50 to $200 higher if rents were not controlled, with a "best" estimate of $95 to $100 per month.[8] This estimate of the change in monthly rent was derived from a hedonic index based on 1974 data on rental units; 1974 was just one year prior to the imposition of rent control. The hedonic prediction equation was used to estimate the 1974 rents for a sample of dwelling units drawn from the rent stabilization registration forms on file with the Rental Housing Administration in 1987. The circa 1974 rent estimates were then inflated to 1987 market rents using an average of the rental CPI for several large uncontrolled cities.[9]

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[5] First the Condominium Act of 1976, D.C. Law 1-89, and then the Rental Conversion and Sale Act of 1980, D.C. Law 3-86.

[6] Turner (1988b).

[7] *Ibid*. p. *i*. These other issues were an assessment of the rent control system in terms of its ability to be understood, and its efficiency, economy, equity, and flexibility; the impact of rent control on small housing providers; the location and number of D.C. residents living in substandard housing; and an assessment of a number of alternatives for expanding the exemptions to rent stabilization (vacancy de-control, luxury de-control, and increasing the small landlord exemption), and an assessment of an alternative for determining rent ceilings.

[8] Turner (1990, 8).

[9] The reader should note that the findings on the rent differences attributed to the D.C. rent control program by UI are quite sensitive to the inflation adjustment used to predict rents in the absence of rent control. Additionally, UI found that rent control depressed the rents of exempt units, a condition that is contrary to the expected outcome for a bifurcated market. See Olsen (1990).

The UI analyzed the rent changes it predicted and found that the benefits were not spread equitably or efficiently. Generally, long-term tenants — lower income renters, elderly households, and families with children — benefited the most from D.C. controls, and since rents are reset for new tenants, recent movers therefore paid as much, if not more, that they would in the absence of controls. In the late 1980s context, affluent renters moved more frequently than others did so presumably a lower fraction of higher income tenants benefited from rent control than tenants with lower incomes, given the finding that recent movers benefited less. Thus, if higher income renters stayed in their rental housing for an extended period they also obtained benefits, and if lower income tenants moved, they paid rents just as high as those prevailing in the open market.

Regulatory Reform

Through the National Capital Revitalization and Self-government Improvement Act of 1997 (Public Law 105-33) the U.S. Congress directed the Authority to undertake a complete review of the regulations and permit and applications processes under which businesses and individuals operate in the District of Columbia. Congress charged the Authority with determining the extent to which such regulations unnecessarily and inappropriately impair economic development in the District of Columbia and the financial stability and management efficiency of the District government. The Authority was also directed to take such additional actions as it considered necessary to repeal or revise the regulations of the District of Columbia, in accordance with Section 207 of the District of Columbia Financial Responsibility and Management Assistance Act of 1995 (Public Law 104-8). Subsequently, the Authority retained Holland & Knight LLP, *et al*. to help carryout its mandate under the Revitalization Act.[10]

The regulatory reform project team reviewed all of the District's regulations to identify reforms that would help significantly improve the District's economic environment by removing major regulatory and procedural impediments to economic development. The project team was also charged with identifying regulations and procedures that place a significant burden on consumers and impede governmental management efficiency, and recommending a plan for both immediate and near-term reform. The Authority's mandate from Congress concerning regulatory reform included the requirement that the review take into account the work and recommendations of the Business

[10] District of Columbia Financial Responsibility and Management Assistance Authority (1998).

Regulatory Reform Commission that had been prepared pursuant to the Business Regulatory Reform Commission Act of 1994 (D.C. Code, sec. 2-4101 *et seq.*).

The Authority's regulatory reform project identified 14 areas of regulation that would benefit from reform. The 14 priorities had been culled from an initial list of more than 70 areas, which had been prioritized by undertaking a gross cost-benefit analysis. The gross cost-benefit analysis assessed such issues as the impact on the cost of doing business; whether a more efficient or different process would retain business in the District or attract new business; whether a change would enhance the efficiency of the agency or department; whether the change would improve the quality of life, create jobs, or enhance or detract from public safety; and whether the change would eliminate or increase uncertainty in doing business in the District. In this process, higher priority was given to areas that (1) significantly affect the District's economy, (2) affect relatively large or significant segments of the business community, (3) produce great potential benefits, (4) could be solved in a relatively short period, and (5) are relatively easy to put in place.

Rent control was considered to be a high priority area for reform. While recognizing the validity of arguments both in favor of and in opposition to rent control, the regulatory reform project team concluded that rent control in the District of Columbia did not appear to be meeting its stated objective to create greater housing opportunities for low- and moderate-income residents. But at the same time, Holland & Knight recognized that discontinuing rent control had the potential, in the short term, to cause significant pain to various segments of the D.C. population. In effect, further study would be required before making a definitive decision on the future of rent control in the District of Columbia. Thus, the regulatory reform project team recommended that the Authority support the following proposed reforms: prompt de-control of rents on units that are vacant, as well as units that become vacant in the future, and assess the impact on low- and moderate- income tenants of terminating rent control on all rental units, and either (1) phase out, within 2 or 3 years, rent control on all units, excluding those occupied by lower income, elderly tenants or (2) substantially simplify and liberalize the procedural and substantive requirements for initiating rent increases.[11]

[11] Holland & Knight, *et al.*, (1998, xvi).

In particular, Holland & Knight suggested that action on its recommendation to phase out rent control over a period of 2 or 3 years be postponed until a study of the likely economic and social impacts of rent control on District residents is completed. The study should identify:

1. The anticipated reduction, if any, in the District's existing supply of affordable housing if the phase-out of rent control occurs.
2. The likely rent increases and changes in services and facilities, if any, that will be experienced by tenants in the District as a result of rent de-control.
3. The expected increase, if any, in development and rehabilitation of affordable housing in the District as a result of the deregulation.

The study is also to discuss the impact that rent de-control has had on low- and moderate-income tenants in other cities, such as Boston.[12]

Objectives and Scope

The purpose of the present study is to assess the likely impacts of rescinding the rent stabilization provisions of the Rental Housing Act on tenants and on the availability of affordable housing for the District's low- and moderate-income renter households. The four questions raised in the regulatory reform policy paper on rent control define the initial terms of reference for the present study. The three specifically enumerated items are concerned with the impact of rent de-control on the supply, price (rent), and investment in rental housing, and constitute the hypothetical market-based impacts of eliminating rent control in the District of Columbia.

- If rent ceilings are eliminated, will existing tenants be displaced because landlords now have a financial incentive to rehabilitate and upgrade existing rental properties?
- How high will rents rise for existing and new tenants with the elimination of rent ceilings?
- Will rental property developers invest in affordable housing for low- and moderate-income tenants if the possibility of future rent regulation is eliminated?

The last of the questions on rent control is a logical inquiry: What can be learned about the possible impacts of rent de-control on low- and moderate-income tenants from the experiences of tenants in other jurisdictions that have eliminated rent control?

Subsequent to the completion of the initial scope of work for this study, the terms of reference were extended to include a brief review of alternative methods of de-controlling rents that may be

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[12] *Ibid*., p. 5-4.

applied by the District of Columbia, and their expected impacts, and Nathan Associates' recommendations concerning which method or methods should be implemented by the District to end its rent control program, if that decision is made.

General Approach

The general approach followed to evaluate the three primary impacts was organized around a thorough analysis of the current status and recent developments in the District's rental housing market. The research and analysis proceeded by first determining likely rent increases — the likely direct and immediate tenant impacts — and then by assessing the likely responses by rental housing providers to the repeal of rent stabilization in the District of Columbia and the likely rent changes. A comprehensive literature search and review was mounted to benchmark the impacts of rent de-control in the District to experiences in other formerly rent controlled markets.

Likely rent changes with de-control are predicted using a statistical model. The statistical model developed for this study is widely used and accepted in applied economic research to answer the questions addressed here.[13] The likely responses of rental housing providers were estimated using a sample survey of owners and managing agents of D.C. rental properties.

Data and Information Sources

Data from a number of sources were collected, compiled, and analyzed in order to forecast the effects of rent de-control. The findings and conclusions set out in this report are based on the analysis of data from both existing sources and data developed by primary survey research. The principal sources are:

1. *The American Housing Survey (AHS).* The AHS is the program of surveys of metropolitan households and housing units conducted by the Census Bureau for the U.S. Department of Housing and Urban Development. More than 44 metropolitan areas are surveyed on a rotating basis, with a national sample survey conducted every five years. The statistical model we developed to assess the likely increases in rents with the elimination of rent stabilization uses data from the 1998 survey of the Washington metropolitan area.
2. *First American Real Estate Solutions.* A database of all residential properties in the District was obtained from First American Real Estate Solutions, which collects property information from the D.C. Real Property Tax Administration. Excluding condominiums and cooperatives, the database contained records for 32,645 rental properties with 149,292 housing units.

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[13] See for example Olsen (1972), and Malpezzi, et al. (1988). See also Olsen (1997) and Pollakowski (1997) for recent applications of this methodology to project the impact of repealing rent stabilization in New York City.

Samples were drawn of these properties to collect unit-specific information regarding rent ceilings and rents charged from the filings at the D.C. Department of Consumer and Regulatory Affairs, and to conduct a survey of D.C. rental housing providers.

3. *Survey of D.C. Rental Housing Providers.* We conducted a survey of the owners and managing agents of District rental properties, exclude public housing, properties where all the units were subsidized, and condominiums and cooperatives. In July 1999, questionnaires were mailed for 3,102 properties to elicit information about whether the property was rent controlled, about rent ceilings, how the property would be affected if rent control were repealed, and other information. A total of 392 usable responses were received.

Other data sources that we relied on include:

- D.C. Department of Consumer and Regulatory Affairs;
- U.S. Department of Housing and Urban Development;
- U.S. Department of Commerce, Bureau of the Census;
- REIS Reports; and
- Delta Associates.

In addition, we sought the advice and input of tenant advocacy groups, housing providers, and developers.

Organization of Report

Nathan Associates' report on its evaluation of the impacts of ending rent stabilization on District of Columbia renters is organized in five chapters including this Introduction and Summary. In Chapter 2 we profile the supply and demand components of the D.C. rental housing market. Chapter 3 covers the probable changes in rents that would occur with the elimination of rent control, and Chapter 4 is our assessment of the probable impacts of ending rent stabilization on the supply of and investment in rental housing. Chapter 5 contains a summary of the findings of our research and analysis. In a separate Appendix we outline the possible strategies that may be utilized to end the District's rent control program in the event that decision is reached.

Summary of Findings

We conclude that the elimination of the rent stabilization in the District of Columbia will have nominally deleterious effects, if any, on District residents that make up the demand for affordable rental housing. The specific form of rent control in place in the District and its mechanics for adjusting rent ceilings, in combination with the softening of the D.C. rental real estate market since the early 1990s, are primary factors in arriving at our conclusion.

The effects of eliminating rent control on tenants and rental housing depend to a large degree on conditions in the housing market at the time regulatory changes would take place. The current market context for the District of Columbia, described in Chapter 2, is characterized by vacancy rates for rental housing that have been elevated by the loss of population earlier in this decade. Contributing to current market conditions is the relative generosity of the rent ceiling increases that are permitted by the District's regulations that implement the rent stabilization provisions of the Rental Housing Act.

At this time, as documented in Chapter 3, the monthly rent for only 17.3 percent of rent stabilized housing units in the District are at their ceiling rates and, therefore, relatively few tenants would be at risk of a rent increase with the elimination of the District's rent stabilization program. The percentages of units at their rent ceilings by quadrant are 16.6 percent in the Northwest, 21.5 percent in the Northeast, and 15.8 percent in the Southeast/Southwest. The percentages of units at their rent ceilings by the typical household income of the property are 18.3 percent for a property with a typical household income of under $25,000, 16.5 percent for a property with a typical household income of $25,000 to $49,999, and 18.0 percent for a property with a typical household income of $50,000 or more. Of tenants in units at their rent ceilings, the largest increases in rent burdens (in terms of the share of the tenant's income that would be consumed by the rent increase) would most likely occur for low-income households that already have the highest rent burdens when compared to higher income groups. The percentage of units at their rent ceilings, the units that would most probably experience rent increases with de-control, will likely not change substantially over the next couple of years, because many units are well below their rent ceilings.

The hedonic price index analysis undertaken for this study estimated that the average rent increase for the District's rent stabilized housing with the elimination of rent control would be in the range of $5.40 to $6.30 or 1.4 to 1.8 percent of monthly rent, if rent stabilization were to be eliminated. If rent increases for the ceiling-rate housing units are responsible for the entire market-wide average increase, then rent increases for the tenants of those housing units at risk would experience average increases of $36.42 or 10.4 percent per month. Eventual occupancy turnover would result in some of these rent increases even with the continuation of rent control.

The District can also anticipate minor impacts from eliminating rent stabilization on the supply of affordable housing and on future investment in affordable housing if current market conditions continue, as discussed in Chapter 4. The rent increases projected for this study are just too modest to stimulate much displacement of sitting tenants. In addition, it is difficult to imagine much of a response from the development community with new or substantially rehabilitated affordable

housing with the elimination of rent stabilization given current market conditions. Furthermore, while rents rose substantially in Cambridge, MA, and other Boston-area jurisdictions with the elimination of rent control in 1996, it is highly unlikely that the District's renters would face the same experiences. Current market conditions in Washington, D.C., stand in stark contrast to the strong demand for rental housing driven by high incomes and low vacancies, that characterized the Boston metropolitan area at the time Massachusetts eliminated rent control.

2. Overview of the D.C. Rental Housing Market

The impacts of a rent control program depend as much on demand and supply conditions in the rental housing market in which the program is implemented as they do on the specific mechanics of the regulations. This chapter establishes the market context for this assessment of the likely impacts of eliminating rent stabilization in the District of Columbia. This market overview begins with a discussion of the long-term trends that are reflected in the rental housing market in the District today. The second section of this overview is a profile of the demand side of the market — the District residents who occupy the District's rental housing units. The third section provides an accounting of the supply of rental housing in the District and the portion presently subject to the rent stabilization provisions of the Rental Housing Act. A few indicators of the current state of the market are highlighted.

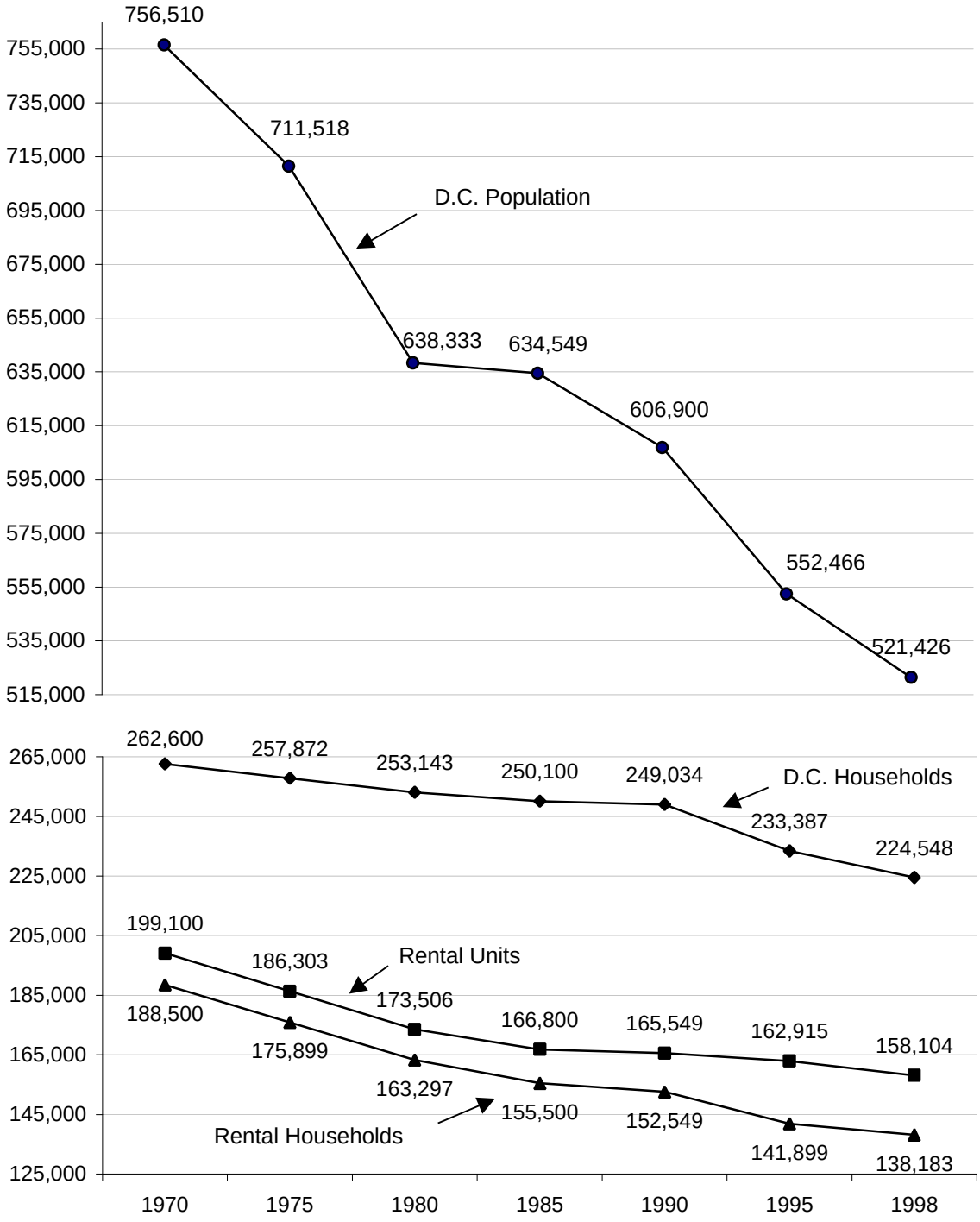
Long-term Trends in the D.C. Housing Market

A simple, but informative picture of several long-term trends that have shaped the present condition of the D.C. rental housing market is presented in Figure 2-1. Included in the figure are trend lines for several measures that reflect the District's residents and rental housing: population, households, rental units, and rental households.

The number and preferences of the resident population drive demand for rental housing. The District's population declined by more than 14 percent from 1990 to 1998, extending a trend that has lasted nearly 40 years. The slower decline in the number of D.C. households from 1970 to 1990 reflects the long-term decline in household size. The more precipitous decline since 1990 is a transitory development tied to the acute conditions in the District of Columbia earlier in the decade.

The number of rental units, in total, and the number occupied (renter households) have generally followed the same downward slope, only to diverge in the 1990s. As the number of renter households dropped 9.4 percent by 1998, parallel to the trend for all D.C. households, the supply of rental

Figure 2-1. D.C. Population, Households, and Rental Units, 1970-1998



Source: Data for 1970, 1980, 1985, and 1990 are from the Bureau of the Census as published in *Consolidated Plan for the District of Columbia, 1996-2000* , Draft, by the D.C. Department of Housing and Community Development. 1975 data are extrapolated. 1995 and 1998 data are from the Bureau of the Census.

housing declined only half as much, 4.5 percent, over the same period. The widening gap between the number of rental units and rental households reflects the increasing number of vacant rental units, a clear indicator of a softened rental housing market.

An important recent development in the D.C. housing market — the rebounding owner-occupied segment — is not represented in Figure 2-1. The District's recovery, boosted by the new home buyers tax credit, has lead to record sales of owner-occupied residential real estate transactions in all parts of the District.[14]

Also not represented in the overview graphic are the east/west distinctions that cut across the District. A recent study by The Brookings Institution Center for Urban and Metropolitan Policy reviewed the state of growth in the greater Washington D.C. metropolitan area and found that the District and the suburbs alike have "pockets of distress" and "areas of affluence."

> The Washington region is divided by race, income, jobs, and opportunity, with the eastern half…carrying the area's burden of poverty and social distress while the western half enjoys most of the region's fruits of prosperity. [15]

In the District, the dividing line is 16th Street, and in Maryland and Virginia it is Interstate 95. To the west are higher income households, public and private investments, and economic expansion. To the east are lower-income families, minorities, and limited economic opportunities.

Occupants of D.C. Rental Housing

D.C. renter households number about 138,000 and account for 61.5 percent of all D.C. households, according to the most recent Census figures available. Renters in the District are a diverse group, but not unlike renters in other urban areas. Selected demographic characteristics of the District's renters are set out in Table 2-1. These figures were reported in the 1998 Annual Housing Survey (AHS) of the Washington metropolitan area, the most recently available data source with detailed information on the occupants of housing dwellings.[16] The personal characteristics highlighted in Table 2-1

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[14] *New York Times* (1999). See also *Washington Post* (1999a).

[15] The Brookings Institution (1999, 2).

[16] The AHS is described in greater detail in Chapter 3. These figures are based on preliminary tabulations released to Nathan Associates on May 3, 2000, and include all renters and not just occupants of D.C. rent controlled properties.

Table 2-1. Selected Characteristics of Occupants in D.C. Rental Housing, 1998

Characteristic	Number of Renters (in thousands)	Percent of Total
Total	**132.3**	**100.0**
Race and Origin		
White	35.4	26.8
Non-Hispanic	32.3	24.5
Hispanic	3.1	2.3
Black	82.8	62.7
Other	13.9	10.5
Total Hispanic	11.8	8.9
Household Size		
1 person	72.1	54.5
2 persons	29.2	22.1
3 persons	14.8	11.2
4 or more persons	16.1	12.2
Median	1.4	
Age of Householder		
24 or younger	13.8	10.4
25 to 44	70.2	53.1
45 to 64	28.6	21.6
65 or older	19.7	14.9
Median	39	
Household Composition		
1 adult, no children	71.6	54.2
2 or more adults, no children	26.9	20.3
1 adult with children	16.8	12.7
2 or more adults with children	16.9	12.8
Educational Attainment by Householder		
Less than 12 years	32.5	24.6
High school graduate	30.6	23.1
Some college	22.8	17.2
College graduate	46.4	35.1
Year of Occupancy		
1990 or sooner	104.4	79.0
1975 to 1989	20.8	15.7
1960 to 1974	5.7	4.3
1940 to 1969	1.3	1.0
1939 or earlier	-	-
Median	1996	

Characteristic	Number of Renters (in thousands)	Percent of Total
Household Income		
Less than $15,000	44.8	33.8
$15,000 to $24,999	24.9	18.8
$25,000 to $49,999	32.8	24.8
$50,000 and above	29.9	22.6
Median	$23,610	
Rent Reductions		
No subsidy or income reporting	98.1	74.2
Public housing authority	11.7	8.9
Government subsidy	15.2	11.5
Other: Income verification	4.5	3.4
Other	2.7	2.0
Monthly Housing Costs		
Less than $300	21.0	15.9
$300 to $399	8.2	6.2
$400 to $499	18.2	13.8
$500 to $599	25.0	18.9
$600 to $699	16.3	12.3
$700 to $799	11.2	8.5
$800 to $999	10.2	7.7
$1,000 to $1,249	7.0	5.3
More than $1,250	9.5	7.2
No cash rent	5.6	4.2
Median (excl. no cash rent)	$564	
Monthly Housing Cost as a Percent of Current Income		
Less than 20 percent	41.8	31.6
20 to 24.9 percent	17.1	12.9
25 to 29.9 percent	12.9	9.8
30 to 39.9 percent	15.2	11.5
40 to 49.9 percent	10.3	7.8
50 to 59 percent	3.5	2.6
60 to 69 percent	4.3	3.3
70 to 99 percent	4.9	3.7
Median	24	
100 percent or more	8.8	6.7
Median including 100 percent or more	25	
Zero or negative income	7.7	5.8
No cash rent	5.6	4.2

Source: *American Housing Survey for the Washington Metropolitan Area in 1998* , preliminary tables produced on February 1, 2000 and released to Nathan Associates on May 3, 2000.

describe the heads of rental households while other characteristics describe the household in its entirety.

The householders in D.C. rental units are predominantly minority, with more than 60 percent being African-Americans. More than 50 percent are from 25 to 44 years of age; 15 percent are 65 years of age or older. Nearly 25 percent of rental householders have not completed high school, and more than one-third are college graduates.

A majority of renter households in the District (55 percent) consist of only one person, and 22 percent include only two people. After adults living alone, the next largest type of household consists of two or more adults with no children (20 percent). Single parent households account for 13 percent of all renters. Many D.C. renter households had moved into their units in the 1990s, 50 percent since 1996. AHS tabulations indicate that more than 37 percent began their occupancy within the preceding 12 months.

The low- and moderate-income (L-M income) renter households are a primary interest of this study. According to HUD standards, families with annual incomes less than the median income for the metropolitan area are considered to have low- or moderate income; median income for the Washington metropolitan area in 1998 was about $72,300. The figures in Table 2-1 indicate that nearly 78 percent of D.C. renter households had incomes that were less than $50,000 and about 34 percent had a household income of less than $15,000.

The median housing cost (i.e., gross rent, consisting of rent and utilities) for D.C. renters was $564 per month in 1998. Forty-five percent of renter households had housing costs in the $400 to $699 per month range, and nearly 16 percent paid monthly housing costs that were less than $300. About 26 percent of D.C. renter households receive some form of rent subsidy, either directly or by means testing.[17] About 36 percent of renter households spend at least 30 percent of their current income on housing. The median rent burden for D.C. renters (housing cost as a percent of current income) is 24 percent, just 1 percent higher than the 23 percent median rent burden for the Washington metropolitan area.[18]

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[17] These could include but are not limited to traditional public housing, Section 8 certificates or housing vouchers, the District's Tenant Assistance Program, and the Section 42 low-income housing tax credit program.

[18] The percentages of renters and median rent burden mentioned here exclude the following groups from the calculations of the respective statistics: households paying more than 100 percent of their current income on housing costs, households with zero or negative income, and renters who do not pay their rent in currency.

Stock of Rental Housing in the District of Columbia

The number of available rental housing units in the District of Columbia was about 158,000 in 1998 and has stayed fairly stable according to the trend line displayed in Figure 2-1. This final section of this overview begins with some characteristics of the stock of rental housing in the District and current conditions in the D.C. rental housing market. The overview is completed with our estimate of the number of rental units that are subject to rent control, and a brief description of the rent stabilized segment of rental housing in terms of property size and location within the District. Separate figures are presented for properties typically occupied by low- and moderate-income tenants.

Characteristics of the Supply of Rental Housing

Selected characteristics of rental units in the District are set out in Table 2-2. These figures were reported by the 1998 AHS, as were the characteristics of renters presented in Table 2-1; the statistics included in Table 2-2 are based on occupied rental units. Two sets of figures included in Table 2-1 — housing costs and subsidy status — are also relevant features of the supply of rental housing.

Most occupied rental units in the District are located in structures built before 1975. Only 13 percent of occupied rental units are in structures built since 1974 and 14 percent are in structures built in the 1960s. About 70 percent were built before 1960.

Rental housing in the District is available in structures of all sizes. Structures containing 4 or fewer units account for 35 percent of the renter occupied housing units in the District. These small buildings include detached and attached single household structures and small multiunit buildings (with two, three or four units). Other small and mid-size structures with 5 to 49 units account for another 35 percent of the occupied stock, and structures with 50 or more units account for the remaining 30 percent.

The typical rental unit in the District includes 3 or 4 rooms, counting all rooms, except bathrooms. Rental units with 2 to 3 rooms account for 44 percent of occupied units, as do 4 to 5 room units. The typical unit also includes 1 or 2 bedrooms (56.2 percent and 29.7 percent, respectively), and one bath (85.6 percent).

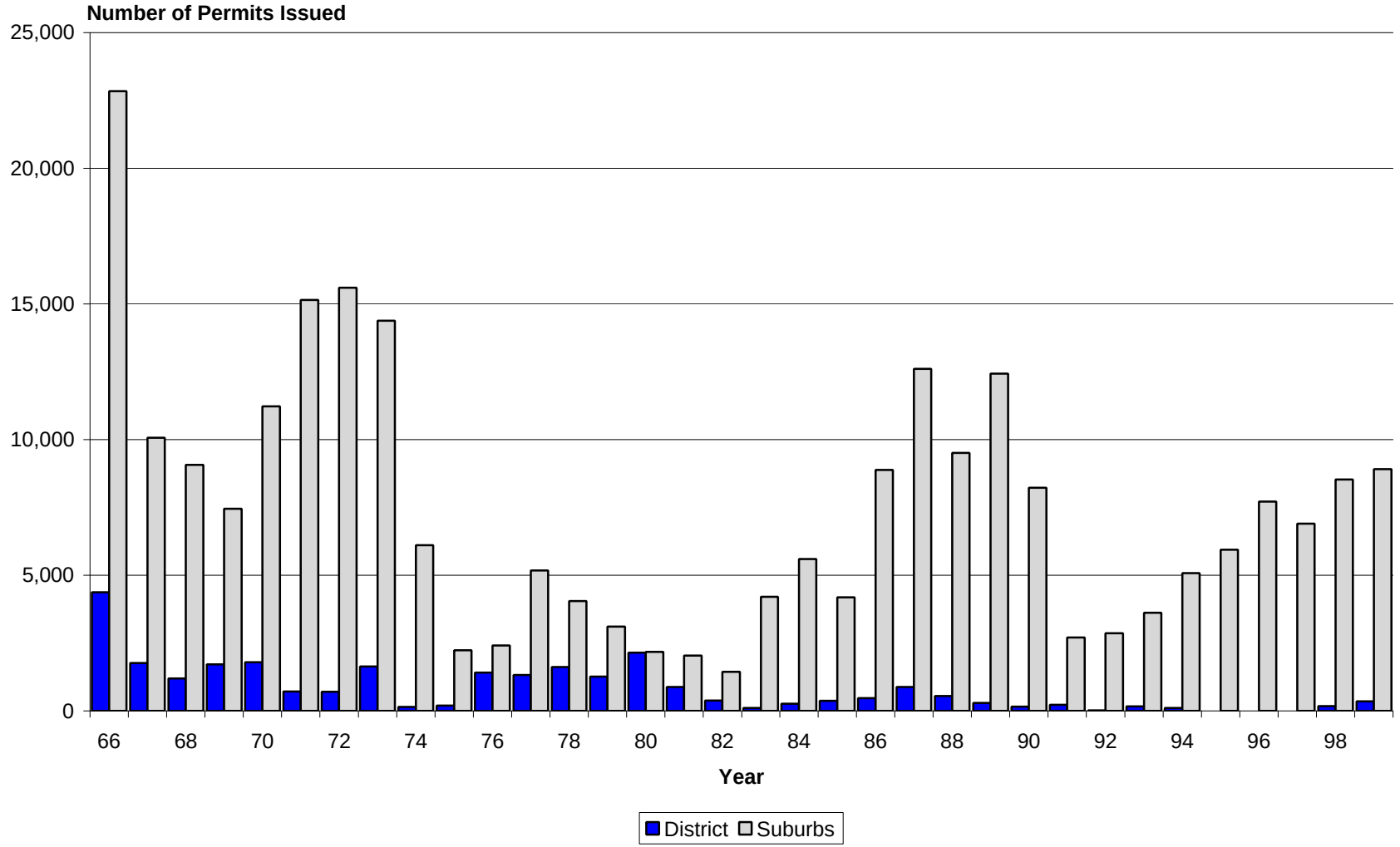
Some of the dynamic features of the D.C. rental housing market are reflected in measures of the construction of new rental units and the utilization of the existing stock. Figure 2-2 and Figure 2-3 present some statistics on the annual volume of building permits. Figure 2-2 presents annual data on

Table 2-2. Selected Characteristics of Occupied D.C. Rental Housing, 1998

	Number of Occupied Units (thousands)	Percent of Total
Total	**132.3**	**100.0**
Year Structure was Built		
1990 or sooner	0.4	0.3
1985 to 1989	6.3	4.8
1980 to 1984	3.5	2.6
1975 to 1979	7.2	5.4
1970 to 1974	4.2	3.2
1960 to 1969	18.2	13.8
1940 to 1960	54.0	40.8
1939 or earlier	38.4	29.0
Median	1949	
Units in Structure		
1, detached	12.2	9.2
1, attached	19.9	15.0
2 to 4	14.4	10.9
5 to 9	9.3	7.0
10 to 19	25.2	19.0
20 to 49	11.8	8.9
50 or more	39.5	29.9
Rooms		
1 room	0.4	0.3
2 - 3 rooms	58.3	44.1
4 - 5 rooms	57.9	43.8
6 or more rooms	15.7	11.9
Median	3.7	
Bedrooms		
None	2.6	2.0
1 bedroom	74.4	56.2
2 bedrooms	39.3	29.7
3 bedrooms	9.7	7.3
4 or more bedrooms	6.4	4.8
Median	1.4	
Complete Bathrooms		
None	1.2	0.9
1 bathroom	113.1	85.6
1 and one-half bathrooms	6.0	4.5
2 or more bathrooms	11.9	9.0

Source: *American Housing Survey for the Washington Metropolitan Area in 1998*, preliminary tables produced on February 1, 2000 and released to Nathan Associates on May 3, 2000.

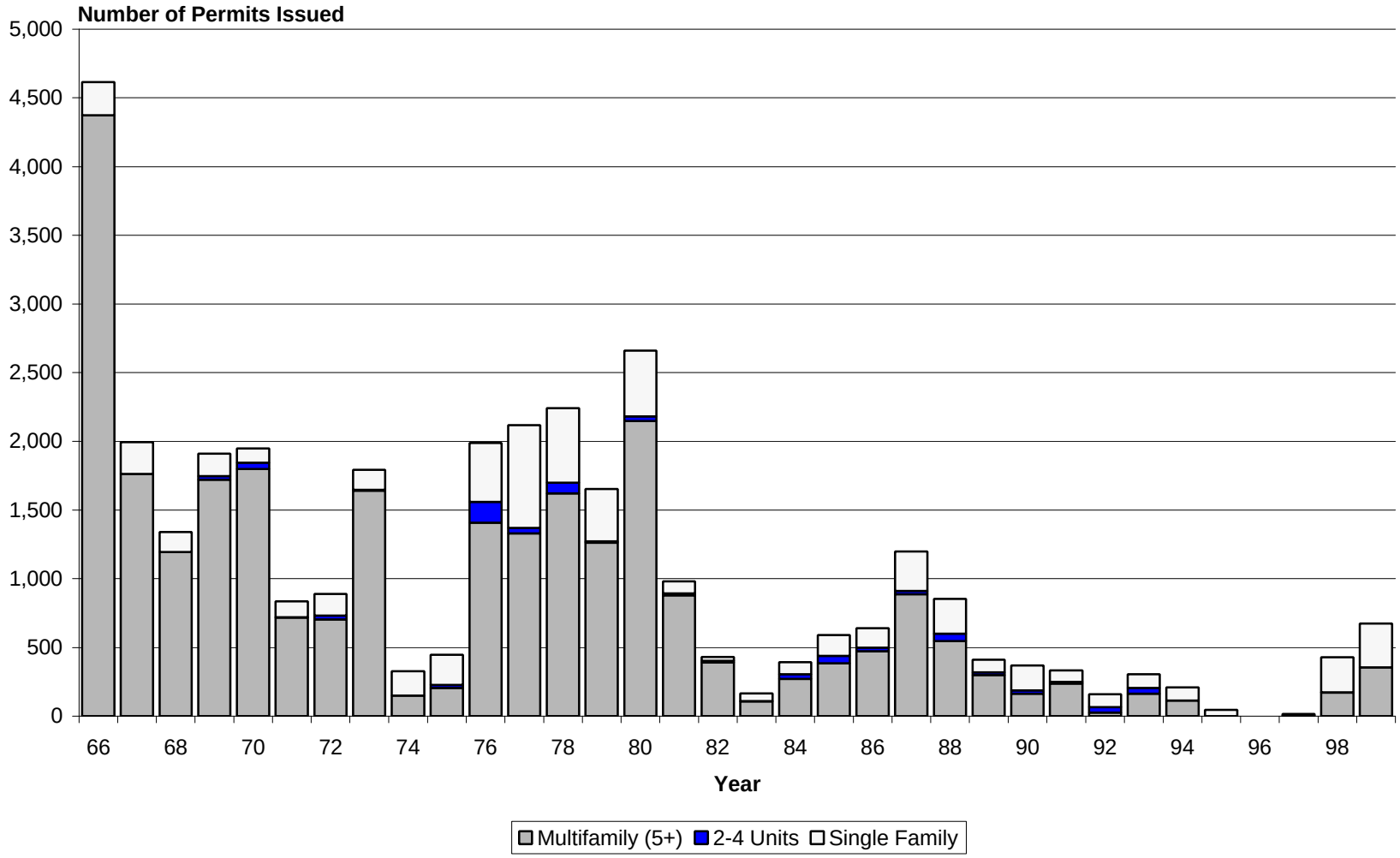
Figure 2-2. Building Permits Issued for New Privately Owned Multifamily Structures in the Washington Metropolitan Area, District vs. Suburbs, 1966-1999



Note: Multifamily structures are defined as residential buildings with five or more housing units.

Source: Bureau of the Census.

Figure 2-3. Building Permits Issued for New Privately Owned Residential Structures in the District Of Columbia, by Structure Size, 1966-1999



Source: Bureau of the Census

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permits for residential properties with 5 or more units, separately for the District and the remainder of the Washington metropolitan area. (Properties with 5 or more units that were built before 1976 are clearly rent stabilized properties.) In Figure 2-3, the data on building permits for the District are reported separately for three building sizes: single family, 2 to 4 units, and buildings with 5 or more units. It appears that the decline in building activity (which is also apparent in the figures on year of construction included in Table 2-2) began in the late-1960s and preceded the imposition of rent control. In fact, new building activity picked up in the late 1970s, but the market has not experienced that annual volume since 1980.

The utilization of the District's stock of rental housing is reflected in the rate of vacancies in rental housing. Vacant rental units are rental units that are not occupied by a tenant. In a simple market model, higher vacancy rates would mean excess supply relative to demand, and would bring about a decline in rents. Alternatively, a lower incidence of vacancies would translate into higher rents. Two vacancy rate series, starting in 1990, are presented in Figure 2-4. The upper trend line is a graph of the rental housing vacancy data reported by the U.S. Census Bureau. It shows a rise in the overall vacancy rate for District rental housing, with a peak of 13.4 percent for 1996. The Census data include all rental properties, private and public, and single and multifamily. The lower line is a graph of a vacancy rate series compiled by a real estate industry source, REIS (Real Estate Investment Services) for the same period. The REIS data pertain only to *investment grade* properties (as described in Figure 2-4, *investment grade* properties are apartments renting at market rates at properties with 40 or more units). The vacancy rates for the REIS properties are lower than the Census figures and have declined over the same period.[19]

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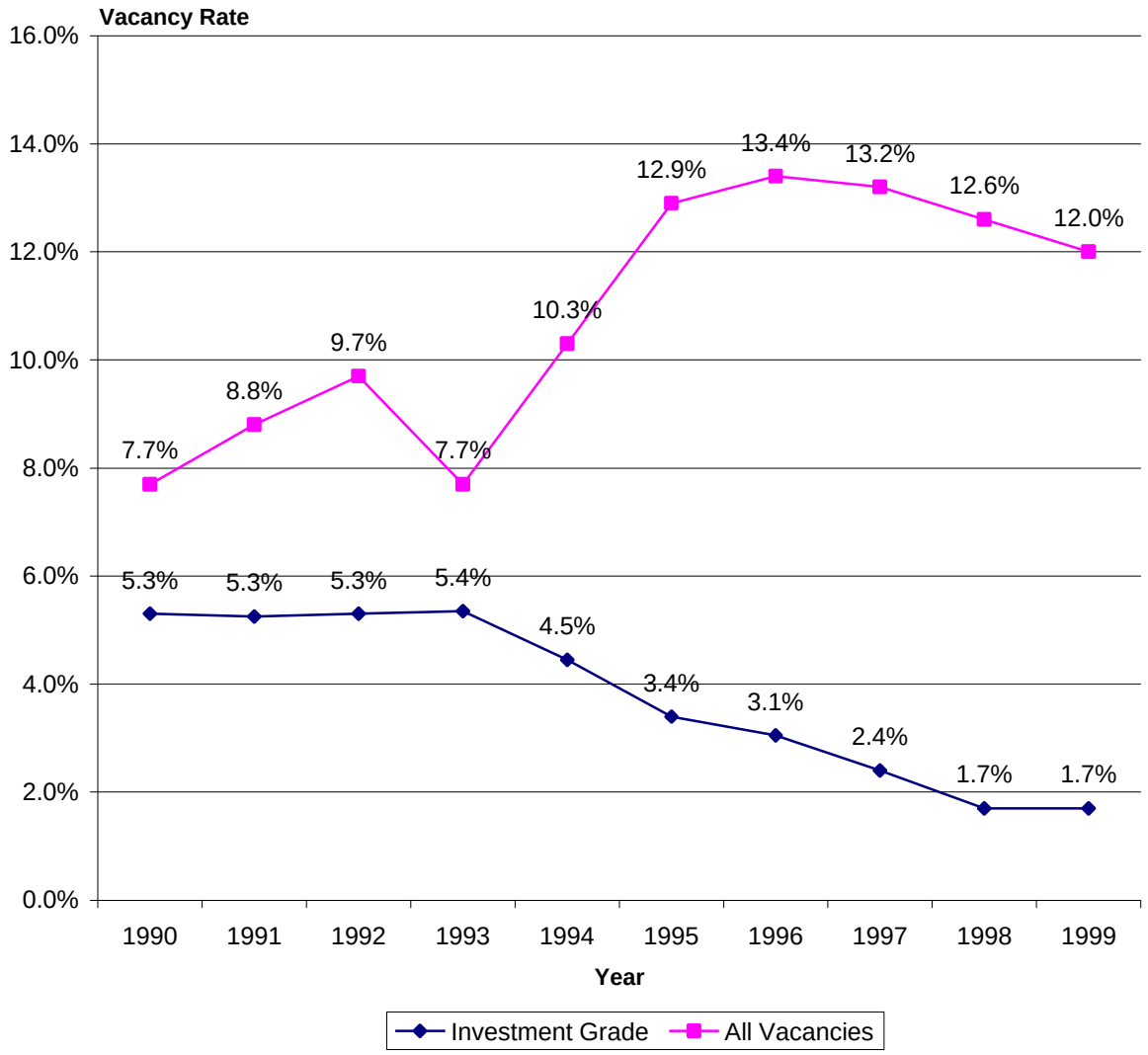
[19] Delta Associates, another real estate industry information source, has reported vacancy rates for District apartments in the range for 1 to 2 percent since 1994. Delta Associates is an Alexandria, VA, firm and its data are cited in the local press from time to time. See for example, *Washington Post* (1999c).

Delta's estimates are based on samples of less than 3,000 units that are surveyed at five or six properties. Delta's figures pertain only to Class A and Class B properties. Class A properties were generally built in 1988 or later and, thus, are exempt from the District's rent stabilization program. Class B properties are well-maintained older buildings that were generally built in the 1960s and 1970s and, therefore, include some rent-stabilized properties. These properties offer few amenities and typically contain 200 or more apartments.

Figure 2-4. D.C. Rental Vacancies, from 1990 to 1999



All Vacancies: Includes both single and multifamily rental properties.

Source: Bureau of the Census

Investment Grade Properties: Includes properties with 40 units or more. Investment grade properties consist only of market rate apartments; therefore, condos, co-ops, subsidized units, furnished apartments, and senior housing are not included in these figures.

Source: The REIS Reports, Inc.
Note: Figures shown are mid-year vacancy rate estimates derived from year-end vacancy rates reported by REIS.

The differences between the Census data and the REIS data are not contradictory; rather, they reflect that some rental properties have not fared as well as others with the District's decline in the early 1990s. The exodus from the District in the 1990s is well known and largely responsible for the rise in unoccupied rental units reported by the Census Bureau.[20] It is quite plausible that the District renters who moved out of the District had, for the most part, resided in the smaller and mid-size rental properties.

Elevated vacancy rates are associated with a softened residential real estate market. Empirical studies of the relationship between vacancy rates and market rents in metropolitan areas have associated declines in real rent increases of 0.6 to 0.9 percentage points with a 1.0 percent increase in the vacancy rate.[21] These studies also report an empirically estimated *natural* vacancy rate of 6 to 8 percent. The natural vacancy rate is the vacancy rate associated with a zero change in rent. The District's overall vacancy rate has been above 8 percent since 1994. Market rate rents fall when the actual vacancy rate is greater than the natural vacancy rate. If current vacancy rates are sustained, the impacts of eliminating rent control in the District on some renters and properties certainly would be moderated.

Rent Controlled Housing in D.C.

Nathan Associates estimates that currently about 101,500 of 160,900 rental housing units in the District of Columbia are subject to the rent stabilization provisions of the Rental Housing Act. We estimated these figures using information tabulated from the property database from First American

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[20] Rental housing providers interviewed for this study reported they were aware of properties with as many as 25 percent of the units unoccupied. The Census figures also include public housing and, although there is a substantial waiting list for public housing, apparently there are a substantial number of unoccupied (perhaps uninhabitable?) public housing units. See for example, "District Gets $30 Million for Housing, HUD Grant to Finance Mixed-Income Dwellings in Blighted SE Neighborhoods," *Washington Post*, September 11, 1999(b), p. B03, which reported 333 occupied apartments out of the 448 public housing apartments at the Fredrick Douglas and Stanton Dwellings developments in Southeast Washington, a vacancy rate of 25.7 percent.

[21] Real rent increases are rent increases on a constant dollar basis.

The classic papers exploring the relationship between vacancy rates and market rents are by Blank and Winnick (1953) and Maisel (1963). Empirical studies include Rosen and Smith (1983), Gabriel and Nothaft (1988), and Malpezzi (1999a).

Real Estate Solutions and the responses to the survey of rental housing providers conducted for this study.[22]

The figures set out in Table 2-3 show the distributions of rent stabilized properties and rental units by quadrant of the District and property size. Smaller properties, with 9 or fewer units, make up 85 percent of all rent stabilized properties, and are located throughout the District. Mid-size properties (with 10 to 49 units) account for 13 percent of all rent stabilized properties while large properties make up the remaining 2 percent.

Rental units in the Northwest quadrant of the District comprise more than 50 percent of all rent controlled properties, with more than half in larger properties (i.e., properties with 50 or more units). About 30 percent of rental stabilized units are located in the combined Southeast/Southwest quadrants, with more in mid-sized properties (with 10 to 49 units) that in larger or smaller properties. The Northeast quadrant accounts for about 19 percent of rent stabilized units, with more located at small properties (9 or fewer units) than mid-size and large properties. Overall, just under one-third of rent controlled units are in small properties, about one-third in mid-size properties, and slightly more than a third in large properties.

In Table 2-4 we have set out the distribution of rent stabilized properties occupied predominantly by low- and moderate-income tenants. The numbers of housing units at these properties are also shown in this table. Low and moderate income households are predominant tenants in 91 percent of all rent stabilized properties and 95 percent of all rent stabilized housing units in the District of Columbia. These figures largely confirm the figures reported by the 1998 AHS for all occupied rental units in the District of Columbia.[23]

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[22] The estimate of the numbers of rent stabilized properties and individual rental units was derived by eliminating 4,881 properties comprising 27,135 units from the 32,645 rental properties comprising 149,292 units compiled by Nathan Associates from the property database. (The last transaction in the database we obtained from First American Real Estate Solutions took place in November 1998.) Neither set of figures includes rental units in cooperative or condominium properties. The reduced property data were arrayed as a survey frame and the sample of rental housing providers was selected from this list. Proportions of rental properties subject to rent stabilization were estimated for sample groups defined by quadrant and property size. These proportions were then applied to the remaining 27,764 properties and 128,598 units, stratified by quadrant and property size, to derive the estimate of rent stabilized properties (13,679) and rental units (101,463). The Urban Institute reported that 100,100 rental units were subject to rent control in 1987. Turner (1988b, 31).

[23] See Table 2-1, Household Income.

Table 2-3. Rent Controlled Properties and Units in the District of Columbia, by Property Size and Quadrant, July 1999

Property Size	Quadrant				Quadrant			
	NW	NE	SE/SW	Total	NW	NE	SE/SW	Total
Properties								
	Number of properties				Percent distribution of properties			
9 units or less	5,103	3,872	2,670	11,645	37.3	28.3	19.5	85.1
10-49 units	613	233	900	1,746	4.5	1.7	6.6	12.8
50 units or more	212	33	43	288	1.5	0.2	0.3	2.1
Total	5,928	4,138	3,613	13,679	43.3	30.3	26.4	100.0
Units								
	Number of units				Percent distribution of units			
9 units or less	12,030	11,263	8,628	31,921	11.9	11.1	8.5	31.5
10-49 units	13,433	5,104	15,444	33,981	13.2	5.0	15.2	33.5
50 units or more	27,609	2,462	5,490	35,561	27.2	2.4	5.4	35.0
Total	53,072	18,829	29,562	101,463	52.3	18.6	29.1	100.0

Note: Percentages may not sum due to rounding.
Source: Nathan Associates Inc.

Table 2-4. Rent Controlled Properties Where the Typical Tenant Household Has an Annual Income of Less than $50,000, July 1999

Property Size	Quadrant				Quadrant			
	NW	NE	SE/SW	Total	NW	NE	SE/SW	Total
Properties								
	Number of properties				Percent distribution of properties			
9 units or less	4,009	3,872	2,571	10,452	32.3	31.2	20.7	84.1
10-49 units	589	233	880	1,702	4.7	1.9	7.1	13.7
50 units or more	196	33	43	272	1.6	0.3	0.3	2.2
Total	4,794	4,138	3,494	12,426	38.6	33.3	28.1	100.0
Units								
	Number of units				Percent distribution of units			
9 units or less	9,401	11,263	8,447	29,111	9.8	11.7	8.8	30.2
10-49 units	13,151	5,104	15,106	33,361	13.7	5.3	15.7	34.7
50 units or more	25,837	2,462	5,490	33,789	26.8	2.6	5.7	35.1
Total	48,389	18,829	29,043	96,261	50.3	19.6	30.2	100.0

Note: Percentages may not sum due to rounding.
Source: Nathan Associates Inc.

Closing Remarks

The current status and recent developments in the District's rental housing market were reviewed in this overview. The supply and demand of housing, and trends that affect each, establish the market context within which the elimination of rent stabilization would take place. That context encompasses a long-term decline in the District's population, and a significant transitory decline in the number of D.C. households since the early 1990s; the latter has resulted in the softened rental housing market of the late-1990s due to increased vacancies for a substantial portion of the market. We also discussed the 101,500 rental units located throughout the city that are rent controlled. The next chapter presents the results of our research and analysis projecting the likely impacts of rent de-control on the occupants of D.C. rental housing.

3. Likely Impacts of Rent De-control on Tenants

Binding rent controls reduce the rents consumers pay, which presumably benefits them, but at a cost borne by landlords and other consumers. Lifting rent controls should reverse the process. Eliminating rent control should increase the rents consumers pay. Ending rent control should also expand the supply and improve the quality of rental housing in response to higher prices, and reduce the risks of investing in rental housing, and result in other indirect effects. The former are reported on in this chapter as the likely impacts of ending rent control on tenants; the latter are addressed in the next chapter (4.) as the likely impacts on supply and investment in rental housing.

Nathan Associates concludes that the average change in rent associated with the elimination of the rent control program for rent stabilized units in the District is *de minimis.* At the present time, the rents for a vast majority (82.7 percent) of the District's rent stabilized units are less than these units' ceiling rents and, therefore, are these housing units' *market* rents. Rent ceilings are binding for 17.3 percent of the housing units subject to the rent stabilization provisions of the Rental Housing Act. Under current market conditions, we estimate that the average increase in monthly rent for rent stabilized housing would be $6.30 or 1.8 percent, and that the average monthly increase for housing units *at risk* of an increase (the 17.3 percent of the controlled units with rents at the ceiling) would be $36.42 or 10.4 percent.

The results of our research and analysis on the rent increases that are likely to occur with the elimination of rent control in the District of Columbia are presented in this chapter of our report. We first discuss, albeit briefly, what economic theory would predict would happen with the elimination of rent control, and then summarize the findings from a study of the impact of eliminating rent control on tenants in Cambridge, Massachusetts. Next, we report our findings from the hedonic price index model and methodology we developed to project the direct impacts of de-control on renters occupying rent stabilized housing units. The model-based findings are then interpreted with the results of our sampling of the required rent and rent ceiling filings by rental housing providers with the D.C. Rental Accommodations Office, and our survey of rental housing providers.

Ending Rent Control: A Simplified Theoretical Explanation

Rent control is a type of price ceiling — a legally established maximum price a seller can charge or a buyer must pay for a good or service. When a price ceiling is imposed on a market, the usual expected outcome is that the ceiling is a binding constraint on the market. A binding constraint is one in which the ceiling is less than the market-clearing price. Binding price ceilings create shortages as consumers demand more of a product or service, but sellers offer less of a product or service, than each would at the market-clearing price. Alternatively, if the market-clearing price is less than the imposed ceiling, the ceiling is not binding and does not have an immediate and direct impact on the price at which supply meets demand.

Rent control programs, like rent stabilization in the District as well as some price ceilings, apply to only a part of a market rather than the entire market. In a market under partial rent control one sector of rental units is subject to rent control and the remaining sector is not. This is referred to as a bifurcated (or divided) market. In a bifurcated market with a binding ceiling, controlled rent will be lower than the rental rate that would exist if the market is unregulated, while the equilibrium rent in the uncontrolled sector will be higher that the market-clearing rent of an unregulated market. The excess demand in the controlled sector created by the partial coverage of rent controls causes or implies greater demand in the uncontrolled sector creating the higher equilibrium rent in the sector not held to the rent controls.

Eliminating rent control in a market with partial coverage should reverse the effects of a price ceiling just outlined. When a price ceiling is removed, rent in the formerly controlled sector should rise to its market-clearing rate as supply expands and demand shrinks. The opposite effects take place in the formerly uncontrolled sector — as the excess demand in the formerly controlled sector is met, the demand spillover to the uncontrolled portion of the market is alleviated and equilibrium rent declines to the market-clearing rate.

Ending Rent Control: The Cambridge, MA, Experience

Understanding the impacts on tenants from deregulating rents in other jurisdictions with rent control is an important element of the present study. Like Washington, D.C., a number of other jurisdictions and local governments initiated rent regulation in the 1970s as a means for its residents to cope with

inflation.[24] "The present economic environment of low growth and low inflation has initiated movement towards de-control."[25] The most well-known cases of eliminating rent controls are California and Massachusetts. The ending of rent control in New York City was considered, but in the end the controls were not repealed.

The California legislature removed controls on vacant units in four communities effective January 1, 1999, the largest being Santa Monica. According to a report in the *Wall Street Journal*, initially rents and vacancies climbed dramatically, but then landlords scrambled to reduce their rents for available rental openings.[26] Under California rent deregulation, rents cannot be raised on occupied units, but only vacant units. This approach to de-control has "led to reports by tenants of controlled apartments that they are being harassed by landlords who would like to see them move."[27] Unfortunately, we have not been able to find anything more than anecdotal information on how Santa Monica renters have faired with rent deregulation, probably because the change took place at the start of 1999.

Massachusetts ended rent control in the Cambridge and Brookline areas at the beginning of 1995.[28] Deregulation involved a phase-out provision for protecting the elderly, disabled, and low-income tenants. Under the phase-out program, de-control did not apply to units occupied by protected tenants in buildings with more than 12 units, an exclusion to de-control that ended December 31, 1996 when all remaining controlled units were de-controlled. Fortunately, the impact of de-control on tenants in Cambridge, MA, has been studied, and we include here a summary of the findings of that research.[29] Some anecdotal information is included to provide a context for the survey results.

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[24] Schoetz (1996, 90).

[25] *Ibid*.

[26] *Wall Street Journal* (1999, A1).

[27] "After Santa Monica Decontrolled Rents," Idea House, National Center for Policy Analysis, http://www.ncoa.org/pd/state/pd042899b.html (July 5, 1999).

[28] According to Schoetz (p. 92), Brookline started the process toward deregulation in 1991 by granting de-control status in cases of owner-occupancy and for two-and three-family dwellings; exemptions were granted for low-income, elderly, and disabled tenants.

[29] Atlantic Marketing Research Company, Inc., and Cambridge Economic Research (1998).

Cambridge Under Rent Control

Cambridge had a system of rent control for a quarter of a century. The rent control regime in the city was strict in that it did not allow for rent fluctuations upon vacancy.

Overview of the Effects of De-control

Rent control was phased out over a two-year period starting on January 1, 1995. Based on a survey conducted jointly by the Atlantic Marketing Research Company, Inc., and Cambridge Economic Research (1998) de-control caused rents to increase, an exodus of working-class, minorities and elderly people, an increase in the number of building permits, and renovation. De-control has had little effect on the poor, because they were not the main group benefiting from rent control. The market value of rental buildings has increased, as has the tax revenue to the city. The city is experiencing an economic boom and building activity has increased dramatically.

Survey Methodology and Results

Atlantic Marketing Research Company, Inc., surveyed 1,000 tenant households, and 50 owners of de-controlled rental units. The first sample was from a computerized listing of renter-occupied residences drawn from the City's Assessing Department and Rent Control databases. A sub-sample of tenants who moved after rent de-control was gathered through the use of the City of Cambridge Street Listing directories for 1994 and 1997 and a survey was mailed to former addresses in the hopes that they would be forwarded to the previous tenants at their new addresses. In all, 474 de-controlled units and 470 market rate units were surveyed. The salient findings of the survey are:

- Median Cambridge rents increased by 36 percent between 1994 and 1997. De-controlled units with new tenants experienced the largest average rent increases (85 percent), market rate units had the lowest increase (13 percent), and tenants remaining in de-controlled units increased 40 percent.
- The vacancy rate fell from 7 percent to under 0.5 percent between 1996 and 1997.
- Sitting tenants of de-controlled units paid the lowest average rent, whereas new tenants of de-controlled units paid the highest average rent.
- Forty percent of all tenants paid more than 30 percent of their annual incomes in gross rent.
- Long-term Cambridge residents, the less educated, the disabled, and households with annual incomes of less than $20,000 typically paid lower rents. Students and those with incomes in excess of $60,000 paid the highest rents.

- Two-thirds of tenants of de-controlled units had not moved since rent de-control. However, the majority of those that moved, did so in response to increases in rent, and most of these people moved out of Cambridge.
- Sitting tenants of de-controlled units had the longest median tenure in their current apartments (8 years), tended to be most uncertain about how long they would stay in their current apartments, had the lowest average incomes, and the largest proportion of elderly people.
- Approximately 10 percent of the total number of households occupying housing units subject to rent control qualified for protected status available under the State phase-out program. About 10 percent of the qualified households ultimately requested and received intervention services offered by Cambridge on the expiration of state-mandated protected status at the end of the 2-year phase-out period.

Economic Context

The state of the local economy and rental housing market are critical to the impacts of de-control on tenants in Cambridge. A recent study on the Massachusetts economy helps provide the proper context.[30] Andrew Sum and his colleagues reached the overall conclusion that Massachusetts as a state, and the Boston metropolitan area in particular, by the 1990s is one of the most expensive places to live in the country. Furthermore, while people of all financial means must negotiate the high cost of living endemic in the state, the challenge is especially difficult for the young and the poor, and whether owner or renter. Some features of the housing market in Massachusetts include:

- Home ownership rates of households in Massachusetts that have consistently lagged behind those of the U.S. although the gap has closed somewhat since 1980.
- During the 1980s, house prices in most areas of Massachusetts that increased at an extraordinarily rapid rate, substantially outpacing the growth of household incomes in the state and the growth rate of house prices in the nation.
- By 1990, a median price of a home in the state that was more than double that of the nation ($163,000 vs. $79,000)
- Massachusetts, with only 2.3 percent of the nation's population, accounted for 10 percent of the most expensive real estate communities with a resident population of 10,000 or more.
- At the time of the 1990 Census, slightly over 40 percent of the occupied housing units in the state were being rented, and the proportion of households renting was even higher among younger households (those headed by a person under 35), low- and middle-income households, and immigrant households, particularly newer immigrants.
- Using a hedonic price model to control for household characteristics, the MassINC study found that market rents for a given quality and quantity are higher in the state. The only areas

[30] Andrew Sum, *et al*. (1998).

with higher rental premiums than the Boston metro area in 1990 were San Francisco, Los Angeles, Honolulu, Anchorage, San Diego, and Washington, D.C.

Important elements in understanding the Boston metropolitan area's high housing costs are the relatively high incomes of area households and families and the limited growth in new housing units. The "(h)igher demand coupled with limited growth…and a very low vacancy rate in rental housing in most parts of the Boston metro area have sharply bid up rents in recent years."[31] Clearly, the rental real estate market in the Boston area was very tight at the time rent control was eliminated, and that condition has continued.[32] The tight condition of the rental market made rent control binding in Cambridge and other communities, and the rent increases that came with deregulation are consistent with the "theoretical" expectations of market adjustments that would accompany the removal of a price ceiling, including the increase in new construction of rental housing resulting from the rising rents.[33] The same tight rental housing market conditions, however, are not present in the District of Columbia. It is likely, therefore, that the Cambridge, MA, experience with rent regulation would *not* be repeated in the District.

Estimating Rents in the Absence of Rent Control in the District

The potential increase in monthly rent for rent stabilized housing in the District of Columbia projected by the hedonic price index methodology applied for this study is modest — an average monthly increase of $5.40 to $6.30 per month, or 1.4 percent to 1.8 percent. In this section of the report we describe the methodology employed to develop these estimates, and then we present and discuss the results of the analysis.

Statistical Model of D.C. De-controlled Rents

Uncontrolled rents for D.C. rent stabilized dwelling units are forecasted to be $19.40 per month higher than the stabilized rents charged to current tenants, based on the statistical model developed for this study. The $19.40 median increase in monthly rent translates into a median increase of 0.4 to 0.7 percentage. Average increases are projected in the range of $5.40 to $6.30, and 1.4 percent to

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[31] *Ibid.* , p. 87.

[32] A number of observers have suggested that Boston's tight housing market and boom-and-bust cycle was related to the very stringent regulation of development during much of the 1980s. Further, this cycle has had adverse distributional consequences. See Malpezzi (1996), Case and Cook (1989) and Case and Mayer (1995).

[33] *Washington Post* (1998).

1.8 percent of current rents. Market rents, and the differences from stabilized rents, were estimated using the method of hedonic price indexes and data from the 1998 American Housing Survey (AHS) of the Washington metropolitan area.

Hedonic Index Methodology

The hedonic price index technique is a well-known statistical method that has many applications in urban and real estate economics.[34] This methodology is well understood and has been used for many years to estimate the market prices of controlled units and, thus, the impacts of rent control on tenants.[35] A simple example helps illustrate the technique.

A hedonic price index is a means to adjust rent differences for differences in unit quality that may be reflected in the condition of the structure, its features, neighborhood character and other characteristics. Suppose we had a sample of rental units that were under rent control and another sample that were uncontrolled. A natural method to crudely estimate the impact of controls would be to average the rents for the units in the uncontrolled sample, and consider this average as an estimate of what rents would be for the controlled sample if controls were removed. Some summary rental information for D.C. controlled rental units and for rental units in the surrounding jurisdictions is set out in Table 3-1. The mean uncontrolled rent in the surrounding jurisdictions is substantially greater than the mean rent for the D.C. rent stabilized units, respectively, $768 and $593 per month, and a difference of $175. The $175 difference, however, overstates the amount that the D.C. units would rent for if rent stabilization were to be eliminated. Among the factors that contribute to the overstatement is the difference in the mix of units in each jurisdiction by size, as reflected by the number of bedrooms in the dwelling unit. As the figures in Table 3-1 indicate, the simple difference

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[34] As explained by Roger McCain, the word *hedonic* "comes from the same root as *hedonism*, the philosophy that holds that the pursuit of pleasure is the highest good. The index is an attempt to measure the pleasure that the person gets from buying the good. This approach has many applications in markets for goods that vary in quality." *Essential Principles of Economics: A Hypermedia Textbook*, http://william-king.www.drexel.edu/top/prin/txt/eqapps/FN1.html (August 31, 1999).

[35] See, for example, such studies as Olsen (1972), Malpezzi (1986), Gyourko and Linneman (1989), and Pollakowski (1997); the Pollakowski paper applied the methodology to project the impacts of de-control in New York City. The Urban Institute (1988) also used this technique in its study of the District's rent control program for the D.C. Council. The theoretical basis for these models is discussed in, for example, Rosen (1974) and Follain and Jimenez (1985). A detailed discussion of the application of the method of hedonic indexes using American Housing Survey data can be found in Malpezzi, Ozanne and Thibodeau (1980).

Table 3-1. Average Rent by Unit Size and Rent Control Status, Washington Metropolitan Area, 1998

	Benchmark Group			D.C. Rent Control Group			Raw	Weighted
Unit Size	Number	Share	Rent	Number	Share	Rent	Difference	Difference[a]
0 bedrooms	427	0.0020	539	2,161	0.0335	569	-30	
1 bedroom	88,505	0.4070	690	41,187	0.6382	556	134	
2 bedrooms	89,274	0.4105	772	16,872	0.2614	633	139	
3 bedrooms	29,078	0.1337	919	2,642	0.0409	708	211	
4+ bedrooms	10,191	0.0469	973	1,676	0.0260	960	13	
Total	217,475	1.0000	768	64,538	1.0000	593	175	93

[a] Raw difference weighted by the share of rent controlled units in each unit size category.

Source: Nathan Associates Inc.

in rents increases with the number of bedrooms. The figures also show that 0, 1 and 2 bedroom units are more prevalent in the District, while units with 3 or more bedrooms are more prevalent in the surrounding jurisdictions. When the simple difference in monthly rents, by number of bedrooms, is weighted by the proportion of D.C. units in each category, the $175 difference in overall means is reduced by more than one-fourth, to $130 per month. In an analogous manner, the hedonic index methodology controls for the different mix of units in the District and the surrounding jurisdictions.

Application of the Hedonic Method in a Rent Control Context

A hedonic price index is a regression of the rents for units against the characteristics of the units that determine their rent or value. Given a sample of housing units, for which we know the characteristics (number of rooms, age and so forth) and their rent, rents are regressed against these characteristics. The coefficients of the regression are interpreted as the amount of money a renter pays for an additional room, for having a unit that is a year newer, a second bathroom, central air conditioning, and so on. The coefficients or implicit prices of the unit's characteristics are applied to the corresponding values of each of the D.C. rental units subject to rent stabilization. Multiplying each coefficient by the value of the relevant variables for a given observation, and then summing the resulting products, yields the predicted market rent of the unit in the absence of rent control.[36]

Each observation's market rent will be estimated with some error. These errors will tend to be self-compensating as long as the estimation procedure minimizes any particular biases. Self-compensating errors are just as likely to be positive as negative, and will tend to cancel out when evaluating the model results in terms of averages or medians of the predictions.

Application in the Washington, D.C. Context

The application of the hedonic method in the Washington, D.C. context presents several challenges:

- Identifying a reliable source of information on D.C. rent stabilized units and their tenants, and the same information about rental units and their occupants in an appropriate comparison group.

[36] A more extensive treatment of the impacts of rent control in terms of consumer surplus includes using the hedonic price index methodology to estimate a consumer expenditure function to assess benefits as well as costs. The information sought for the present study concerns the simple difference in the price of D.C. rent stabilized housing units. In preliminary analyses, we did evaluate the benefits of rent de-control that would be part of the full consumer surplus analysis, and found the results to be quantitatively similar to the results for the cost analysis. Because the results were similar and to simplify our study report, we have not presented a benefit analysis in this report.

- Identifying within the data the rent stabilized units in the District and their characteristics, such as unit size and configuration (e.g., numbers of rooms, bedrooms, and bathrooms), the condition and character of the structure (total number of units, number of floors, defects, etc.), neighborhood character (presence of security devices, nearby unoccupied buildings), and features of the current tenancy (monthly rent, utility costs, length of occupancy, and so on).
- Selecting an appropriate comparison group, with reliable data, to represent the rental terms, quality, character, and conditions of the District's rent stabilized units but without rent regulation.

Each is discussed in turn.

Identifying a reliable data source. Like many others who have evaluated the tenant impacts of rent control, the statistical model developed for this study is based on the American Housing Survey (AHS). The AHS is a program of sample surveys of occupants of both owner- and renter-occupied housing sponsored by HUD and conducted by the Census Bureau. A large national sample of housing units in the United States is surveyed every five years. Housing surveys are also conducted in selected metropolitan areas. Approximately 44 metropolitan areas are surveyed on a rotating basis, providing a reasonable number of alternatives for the benchmark market. We applied the hedonic price index methodology with data from the 1998 AHS of the Washington Metropolitan Area.[37]

Identifying rent stabilized units in the District. Our second challenge is identifying controlled units *per se*. Generally, District units are controlled if they were built prior to 1976, *and* they are owned by a person or entity that owns five or more units of housing in the District. Thus for multifamily housing, all new units are exempt from controls, and all old (pre-1976) units are subject to controls.

For smaller properties — single family units, duplexes and so on — the picture is a little more complicated. A duplex owned by an individual who owns no other units is exempt from controls. A condominium apartment rented by its owner who owns only that unit is exempt from controls. On the other hand a duplex owned by a landlord who owns, say, a dozen such structures in the District, is subject to controls, as would be the condominium owner if he or she owned 5 or more units, whether or not they are located in the same property. We do know, however, that smaller structures built after 1975 are exempt from rent control.

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[37] The 1998 survey for the Washington metropolitan area comprises more than forty-eight hundred observations, and includes both owner- and tenant-occupied housing units.

The American Housing Survey, by design, is a survey of dwelling units and their occupants and, unfortunately for this study, does not have usable information on the characteristics of landlords. Thus we can fairly, straightforwardly segment the D.C. market into controlled and uncontrolled units in the multifamily segment of the market but errors are bound to creep into the single family, duplex, and other small structures.

The American Housing Survey does have a question asked of the tenant, "Is there rent control on the unit?" In principle this variable could be used to separate controlled from uncontrolled unit for our estimation procedure and we considered such a procedure. However, in preliminary work it became apparent that there was substantial incorrect-reporting of the answer to this question. In the aggregate only about one-third of the AHS rental sample was controlled according to tabulations of this variable. Based on the UI study of rent control in the District,[38] and other information, this percentage is implausibly low. Furthermore, we found many cases of old multifamily units where the respondents indicated that they were not aware that they were under rent controls.[39] On balance, based on this preliminary analysis we decided that the AHS question was not sufficiently reliable to use as the basis for discriminating between controlled and uncontrolled units

Identifying an appropriate benchmark. In a more perfect world, with a rental market only partially covered by rent control, the best possible benchmark group might be the rental units that are not subject to rent control. The uncontrolled segment of the District rental market, unfortunately, is not a viable alternative for this analysis. As described above, it is not possible to determine the rent control status of the District's small rental properties. Furthermore, initial analysis of the AHS survey data showed that there were very few new multifamily units in the District, i.e., units that could be readily identified as uncontrolled. In fact there were only twelve such observations in the entire metropolitan American Housing Survey for 1998. In addition, we were concerned that these units could well be unusual or unrepresentative of the District's rental housing stock as a whole. In fact, a significant proportion of the multifamily rental housing built in the District in the recent past was built with assistance from the Section 42 low-income housing tax credit program. These units are built with the aid of substantial subsidies to the developer (who can be either a for-profit or a

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[38] Turner, Technical Supplement IV (1988b, Exhibit A.2).

[39] The inability of tenants to accurately report the rent control status of their unit seems to be a common problem. The Urban Institute reported the same problem with the survey of District residents it conducted for its study. Turner, Technical Supplement II (1988b, II-29). Hamilton, *et al*., Technical Appendices (1985, 10) report the same problem in their study of the impact of rent control in Los Angeles.

non-profit developer). Rents are controlled for these units, but the controlled rents are computed differently than under the District's rent stabilization program. The exact level of rents depends on the type of project and is based on a percentage of the area's adjusted median income. Thus, to the extent some if not most of these eight units were built under the tax credit program they actually would be controlled, albeit under a different form of control then the District's stabilization program. Given that there were only twelve observations to begin with, we decided that a sample of District rental units not subject to rent control was not a viable alternative for the benchmark group.

Given that there are effectively no observations within the District itself which we can reliably consider as uncontrolled units for estimation purposes, we considered several other alternatives. These included using the units within the District flagged as uncontrolled in the American Housing Survey's own question, but we found that unreliable as discussed above. We considered using several other cities including Baltimore and Minneapolis, but our preliminary investigations found that the determinants of rents in those cities differed too much from the District and Washington area. The next alternative we considered was to use the entire metropolitan area, which would include such close-in locations as Arlington, Alexandria, and Prince Georges County, but also locations further out in Loudon and Prince William counties among others. We ultimately settled on the surrounding and contiguous jurisdictions of Prince George's County and Montgomery County in Maryland, and the City of Alexandria, and Arlington County and Fairfax County in Virginia (see Figure 3-1 for a map of the jurisdictions included in the benchmark group). Our belief is that these close-in locations constitute a much better comparison group for the District's rental housing than those farther out.[40]

We are not under any illusion that the District and the surrounding jurisdictions are identical, but to the extent we can, we control for differences in terms of structure of the unit, socio-economic composition of the neighborhood, and so on. For reference we can examine results from the estimation of a pre-control hedonic index for 1974 from a multimetropolitan area analysis of rent determinants.[41] At that time it was clear that after controlling for differences in structure, neighborhood, and so on that the prices in the surrounding jurisdictions were lower than prices in the

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[40] Utilizing a comparison group from the surrounding jurisdictions with a large number of older units is also appropriate because most of the District's rental housing stock is older. Even though the regression analysis we undertake controls for the age of the unit, every thing else equal, it is always desirable to try to have a sample which is in so far as possible qualitatively similar to the group for which we want to ultimately estimate market rents.

[41] Malpezzi, Ozanne and Thibodeau (1980).

Figure 3-1. Washington, D.C. and Surrounding Jurisdictions
(Montgomery County and Prince George's County, MD;
Fairfax and Arlington County, and City of Alexandria, VA)

Source: Bureau of the Census

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District proper, by factors ranging from about five to eleven percent. However, in a fast growing metropolitan area like Washington we would expect, and many studies confirm, that these differences would have shrunk if not been entirely eliminated between these close in locations.[42] The surroundings jurisdictions may not be the ideal proxy for the hypothetical District rental housing market "but for" the rent stabilization program, and if it is not, the comparison is still useful in understanding the rental housing market in the District *vis-à-vis* its neighbors.

Analytical Samples and Results

Two analytical samples were prepared from the 1998 AHS for the Washington metropolitan area; one representing D.C. rent stabilized housing units and the other representing rental housing units in the jurisdictions surrounding the District. Starting with the 4,816 observations in the AHS sample, ineligible households were removed if the unit met one of the following conditions:

- Located in a county that is not among the surrounding jurisdictions,
- Owner-occupied,
- Tenant receives public housing assistance,
- Units in D.C. built after 1975.

Additional observations were removed from the otherwise eligible households if their survey record included missing values for any of the following primary explanatory variables:

- Rent,
- Income,
- Number of bedrooms,
- Number of bathrooms,
- Race, and
- Length of tenure.

Removing the ineligible and incomplete cases left 954 survey responses, representing 411,069 rental households and rental units.

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[42] The phenomena of shrinking price differentials between central cities and suburbs, especially close-in suburbs, is a standard tenet of urban economics. Classic articles such as Alonso (1964), Muth (1969) and Mills (1972) illustrate the way in which this happens. In essence, stripped of the technical details, as cities grow in size and household incomes rise, and as transport costs fall over time with the addition of new infrastructure, price differences between older central cities and close in location begin to disappear. Follain and Malpezzi (1981) present empirical evidence that this is in fact the case.

The hedonic model used to predict the changes in rent that are reported in the next section of this chapter was estimated with the entire database. Since we cannot validly distinguish controlled units in the District using the age and structure size variables alone, we tabulated the predicted rent changes for three major subsets of District rental units in addition to eligible rental units in their entirety. The first subset was limited to only units in buildings with five or more units (we refer to this segment as *multifamily* even though buildings with two to four units also house more than one household). The second and third subsets were defined by restricting the tabulations from the *all buildings* and *multifamily buildings* datasets to rental units occupied by residents with low or moderate incomes (referred to as the *L-M income* category).

As already noted, we can get a much cleaner identification of controlled versus uncontrolled for multifamily properties which argues for focusing on the estimation for the larger properties. On the other hand, while the majority of the rental housing in the district is multifamily, there is a significant portion represented by small properties (single family, duplex, and so on). It is as undesirable to eliminate observations from our database as it is to predict and analyze changes in rent for a sample with misclassifications. We are more confident of the precision of our estimates for multifamily only, but we believe it is possible that examining multifamily properties only might give a somewhat distorted picture of the overall rental housing market in the District. Thus we look to see if we get qualitatively similar results for the *all buildings* and the *multifamily buildings* segments. If we do it may be reasonable to conclude that we have done a fair job of segmenting the controlled and uncontrolled units.

Selected characteristics of the D.C. rent stabilized units and the rental units located in the surrounding jurisdictions are set out in Table 3-2 to permit a comparison of the District renters with their counterparts in the surrounding jurisdictions. Separate tabulations are included for each of the four analytical variants: (1) all buildings and all income categories; (2) all buildings and L-M income categories; (3) multifamily buildings and all income categories; and, (4) multifamily buildings and L-M income categories. These figures indicate that there is a reasonable overlap between the District's and the surrounding jurisdictions' rental units and their occupants.

The sample sizes of the eight samples, and the populations they represent, are set out in Table 3-3. The techniques applied for model development, and the resulting hedonic price equation, are outlined in the next section.

Table 3-2. Comparison of the D.C. Rent Control and Benchmark Groups for Selected Characteristics, 1998 (Percentages Unless Otherwise Indicated)

	All Buildings				Multifamily Buildings			
	All Renters		L-M Income Renters		All Renters		L-M Income Renters	
	Control Group	Benchmark Group	Control Group	Benchmark Group	Control Group	Benchmark Group	Control Group	Benchmark Group
Households (000)	80.7	279.8	67.4	210.4	45.2	125.5	39.4	104.2
Sample Size	185	651	155	487	103	289	90	239
Age of Head Householder								
Under 24 years	12.3	10.2	12.8	11.4	15.7	11.1	15.8	11.3
25 - 44 years	54.8	64.3	54.4	64.3	52.2	62.0	53.0	63.7
45 - 64 years	21.5	20.5	21.3	18.4	24.6	20.0	22.5	17.4
65+ years	11.3	5.1	11.6	5.9	7.6	7.0	8.7	7.5
Building Size								
1-2 units	29.7	47.0	27.7	42.2	n.a.	n.a.	n.a.	n.a.
3-4 units	5.8	3.2	6.3	3.2	n.a.	n.a.	n.a.	n.a.
5-19 units	26.2	32.4	26.7	36.8	43.0	66.0	42.5	68.7
20-99 units	17.4	5.1	18.9	5.0	29.3	10.7	30.3	9.2
100+ units	20.9	12.3	20.4	12.8	27.7	23.3	27.2	22.1
Income								
< 25,000	43.0	17.9	51.4	23.9	44.4	21.0	51.0	25.3
25,000 - 50,000	30.0	38.2	35.9	50.8	33.2	41.6	38.1	50.1
50,000 +	27.0	43.8	12.7	25.3	22.4	37.4	11.0	24.6
Length of Tenure								
Recent mover	18.3	20.3	17.3	20.9	18.4	19.5	17.7	19.5
1-2 years	38.0	47.8	37.6	47.4	36.4	48.4	37.1	47.2
3-5 years	19.8	15.8	21.1	15.3	22.2	14.8	22.1	15.8
6+ years	23.9	16.1	24.0	16.4	23.0	17.3	23.0	17.6
Sex of Head Householder								
Male	47.6	48.4	45.7	45.2	51.5	46.8	46.6	44.5
Female	52.4	51.6	54.3	54.8	48.5	53.2	53.4	55.5
Education of Head Householder								
< High school grad	18.6	13.4	19.6	12.7	16.4	15.8	16.6	14.2
High school grad	23.1	19.0	24.4	21.1	26.1	20.0	26.5	21.7
Some college	15.8	23.1	17.6	24.4	16.0	23.4	18.4	25.6
College grad	24.6	26.5	24.4	26.7	25.4	22.8	24.6	22.2
Post grad	17.8	18.0	14.0	15.0	16.0	18.0	13.8	16.3
Unit Size								
Efficiency	0.6	0.1	0.7	0.2	1.0	0.0	1.1	0.0
2 - 3 rooms	46.1	23.2	49.3	26.9	55.6	31.9	55.9	33.9
4 - 5 rooms	42.4	54.3	42.8	56.4	42.3	62.4	41.7	61.5
6+ rooms	10.9	22.4	7.2	16.5	1.1	5.8	1.3	4.5

(Continued)

Table 3-2. (Continued)

	All Buildings				Multifamily Buildings			
	All Renters		L-M Income Renters		All Renters		L-M Income Renters	
	Control Group	Benchmark Group	Control Group	Benchmark Group	Control Group	Benchmark Group	Control Group	Benchmark Group
Size of Household								
1 person	56.8	33.0	64.7	38.5	62.1	40.3	67.8	43.3
2 persons	22.3	32.1	16.2	31.0	19.6	31.7	15.7	31.2
3 persons	10.6	16.4	10.7	15.1	9.5	12.4	9.8	12.5
4 or more persons	10.3	18.5	8.3	15.5	8.8	15.5	6.7	13.0
Race of Head Householder								
White	30.2	45.1	24.9	42.8	24.6	40.3	23.7	39.5
Black	57.3	31.9	62.7	35.8	56.1	38.4	58.7	42.1
Hispanic	2.2	10.0	2.0	8.3	2.9	8.5	2.3	7.4
Other	10.3	12.9	10.3	13.1	16.4	12.8	15.4	11.0
Life Cycle Group								
Adult living alone	47.1	29.3	53.8	33.9	55.5	34.4	60.2	36.9
2+ adults no childr	21.4	34.6	13.8	30.0	17.9	30.6	13.8	26.2
2+ adults with chilc	12.8	23.3	12.1	20.7	12.6	19.0	9.9	18.3
One parent familie	7.3	7.8	8.8	9.4	6.4	9.1	7.4	11.0
Elderly, age 65+	11.3	5.1	11.6	5.9	7.6	7.0	8.7	7.5

Note: Percentages may not sum to 100 percent due to rounding.

Source: *American Housing Survey for the Washington Metropolitan Area in 1998*, public use dataset released April 27, 2000.

Table 3-3. Analytical Groups and Sample Sizes for Hedonic Model

Analytical Group		Sample Sizes (Number of Households)		
Building Type	Income Group	Total	Surrounding Jurisdictions	District of Columbia
All	All	836	651	185
All	L-M	642	487	155
Multifamily	All	392	289	103
Multifamily	L-M	329	239	90

Source: Nathan Associates Inc.

Model Specification and Parameter Estimates

The hedonic price regression for the rental housing market in the surrounding jurisdictions that we developed to predict market rents for District controlled units in all building types is presented in Table 3-4. In turn, we discuss the selection of the explanatory variables (parameters) included in the models, the estimation steps including the techniques we used to control for excessive influence and eliminate statistical outliers, and the parameter estimates, model fit, and significance.

Parameter selection. The hedonic specification was chosen as follows. First an initial set of variables was chosen based on many prior studies of hedonic prices using annual housing survey data.[43] Our specification of an initial set of variables was, by design, a somewhat parsimonious one. With large samples and no need to predict rents for units out of sample many studies make use of a large number of variables and very flexible functional forms. Alternatively, to the extent the sample is small rather than large, and in particular when one is predicting out of sample (as is our intent here), it is important to be concerned with issues related to degrees of freedom. Additionally, it is also important to be aware that very flexible functional forms of explanatory variables (e.g., quadratic terms) may yield unexpected results when used to predict the rents for units out of sample.[44]

The variables we chose based on prior studies included: the number of rooms, the number of bathrooms, the age of the structure, the number of living quarters in the structure, and whether utilities are included in rent. The contribution each of these characteristics makes to rent is fundamental and easily understood. In addition we include several tenant characteristics that we hypothesize may affect the price paid per unit of housing services, or that may be proxies for neighborhood effects.

Another category of variable added to the hedonic is location-based dummy variables. The surrounding and contiguous jurisdictions designated as the benchmark area for this analysis includes five locations: Prince George's County, Montgomery County, Arlington, Alexandria, and Fairfax. Dummy variables were constructed for the latter four and Prince George's County is the omitted category.

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[43] See for example Malpezzi, Ozanne and Thibodeau (1980), Blackley and Follain with Lee (1995), and Thibodeau (1995).

[44] Follain and Malpezzi (1980) present evidence that for the purposes of predicting rents as we do here a small set of ten or so carefully chosen variables will generally do as well as a larger set of thirty or forty variables.

Table 3-4. 1998 Hedonic Rent Regression

Variable	Parameter Estimate	Standard Error	Prob > | T|
Intercept	5.774634	0.13077544	0.0001
Single-family detached	0.042503	0.02225224	0.0566
Single-family attached	-0.025996	0.01755086	0.1391
Number of floors in bldg	0.003081	0.00413911	0.4569
Elevator 0-1	0.075824	0.02838712	0.0078
Rooms	0.058298	0.02740564	0.0338
Number of rooms squared	-0.001593	0.00228888	0.4867
Total number of bathrooms	0.057534	0.04470852	0.1986
Squared number of bathrooms	0.007109	0.01028398	0.4896
Num of bedrooms	0.088419	0.03211417	0.0061
Squared number of bedrooms	-0.007711	0.00572034	0.1782
Central air 0-1	0.1238	0.03190109	0.0001
Approximate year bldg built	-0.004474	0.00167705	0.0078
Squared approximate year bldg built	0.000054178	0.00001403	0.0001
Num of living quarters and vacant	-0.000272	0.0005617	0.6278
Squared number of units	0.000001355	0.00000179	0.4494
Resident owner	-0.028952	0.01807053	0.1096
Washing machine	0.081069	0.01642222	0.0001
Room air conditioner	0.012243	0.03554277	0.7306
Working fireplace	0.057544	0.01981974	0.0038
Moderately inadequate unit	-0.025659	0.02211726	0.2464
Severely inadequate unit	-0.11558	0.03956264	0.0036
Bars on nearby windows	0.003655	0.06789624	0.9571
Resident satisfaction w/ residence	-0.002931	0.00433664	0.4994
Resident satisfied w/ neighboorhood	0.007512	0.00402056	0.0622
Length of tenure	-0.00951	0.00315089	0.0026
Length of tenure squared	0.000291	0.00015042	0.0533
African-American 0-1	-0.046799	0.0156689	0.0029
Hispanic respondent	-0.029467	0.01706633	0.0847
Utilities included in rent 0-1	0.073368	0.01408824	0.0001
Arlington County	0.142039	0.03719928	0.0001
Montgomery County	0.031697	0.03344802	0.3437
Alexandria City	0.066149	0.03136565	0.0354
Fairfax County	0.026548	0.03586397	0.4594
Average annual income per zone	0.000001035	0.00000083	0.2113
Percent black per zone	-0.073439	0.06161561	0.2338
Log of income	0.019218	0.00669708	0.0043
Poverty incidence in zone	-0.157359	0.26929193	0.5592

Analysis of Variance

Source	DF	Sum of Squares	Mean Square	F Value	Prob>F
Model	37	36.40771	0.98399	50.209	0.0001
Error	613	12.0135	0.0196		
C Total	650	48.42121			
	Root MSE	0.13999	R-square	0.7519	
	Dep Mean	6.68683	Adj R-sq	0.7369	
	C.V.	2.09356			

Source: Nathan Associates Inc.

Estimation and outlier analysis. In preliminary regressions we started with the set of core variables and then used step-wise regression methods to select several additional variables from a longer list. The number of bedrooms, whether the unit had central air conditioning, and the length of tenure squared were among the variables that were observed to be significant. These were therefore added to the specification.[45] Neighborhood-level measures of average income, percent black, and incidence of poverty representing additional contextual influences were also included in the model specifications; the AHS zone designations were used for this purpose.[46]

We found a number of observations to be statistical outliers; that is, the predicted rent from the regression was very different from the actual rent even for a unit within the sample. Visual inspection found that many of these units were apparent anomalies, such as units renting for less than fifty dollars per month, or in one case a 7 room, 2,00 square foot unit in Montgomery County renting for one hundred dollars per month. Some of these observations could be due to miscoding or misreported data, but it is also possible that they represent unusual housing situations of some other kind. We identified and eliminated statistical outliers using a procedure based on definitions of outliers suggested by Tukey (1979).[47] The outlier procedure used is conservative in that fewer then one in two hundred observations were expected to meet the criteria for elimination.

We also adopted a procedure called bounded influence regression to develop the parameter estimates.[48] The bounded influence procedure downweights observations that are deemed excessively influential. An influential observation is one that has a much larger effect on the regression than could be expected in a well-specified model if classical assumptions held.[49]

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[45] A number of recent studies of controls such as Ault (1990) have pointed to the possibility of selection bias in hedonic price models applied to controls. Malpezzi (1986) examined this issue in the context of Cairo's rent control and found that while the selectivity bias correction was significant, it in fact had very little effect on the predicted rents or other final results. We undertook a similar test with our data, estimating a first stage selection model following Olsen (1980). The selectivity bias correction factor, while statistically significant, made little difference in rent predictions for D.C. rental units and we decided not to include the selection variable in the final model.

[46] The AHS divides jurisdictions into zones that are socio-economically homogeneous areas with population greater than 100,000.

[47] This procedure is described more fully in Malpezzi, Ozanne and Thibodeau (1980).

[48] We adopted the methodology advocated for such models by Belsley, Kuh, and Welsch (1980).

[49] See Welsch (1980) for further details.

Parameter estimates, model fit and significance. The hedonic regression model (Tables 3-4) performs broadly as expected. The fit for the regression model is quite good by any standard. We explain almost three-fourths of the variance in the dependent variable.

Among the unit characteristics, as one might expect, the number of rooms and number of bedrooms drive rents, although the effects on rent diminish as the numbers becomes large. Also significant are the presence of amenities, such as central air conditioning, a clothes washer, and a fireplace. As one would expect, the monthly rent is higher if utilities are included, and lower if the unit has noticeable defects.

Building characteristics significantly associated with rent include the age of the building and whether an elevator is present. The number of units in the building does not appear to be important. Among the single-family households included in the model, whether the unit is located in a detached or attached single family property is important in determining monthly rent.

In terms of neighborhood characteristics the race of the head of household and the household's income, proxies for neighborhood effects, are significant as is whether the property is located in Arlington or Alexandria relative to Prince George's Country. The average household income in the zone in which the property is located is not significant when the income of the household is held constant; the same relationship does not hold with regard to the racial composition of the zone.

More generally, several of the quadratic terms such as those for number of rooms in the unit, number of bedrooms, and number of units in the building are not significant, suggesting simple log linear relationships are sufficient to capture the true relationship between characteristics and rents.

Predictions of Changes in Rents

The hedonic models are used to estimate the prices of D.C. rent stabilized units if they were part of the rental housing market in the surrounding jurisdictions. Predictions of the changes in rents with the elimination of rent de-control are the differences between the hypothetical market rents and the actual contract rent paid by the occupants of the D.C. rent stabilized units.[50] The change in rent can be expressed as the dollar difference or the percentage difference in monthly contract rent. The variables in the models allow us to control for the fact that typical District units are somewhat

[50] Contract rent includes the cost of utilities in the monthly rent, whether or not the utility costs are included in the actual rent paid by the occupant.

different from typical units in the surrounding jurisdictions. The determinants of relative prices of housing are probably quite similar in reality between the District and locations in the surrounding jurisdictions.

Exhibit 3-1 and Exhibit 3-2 present summaries of the predictions of the changes in monthly rent for the *all buildings* (both single family and multifamily units together), and *multifamily* segments in the District that we identified as controlled following the criteria adopted for this study. Changes in monthly rent are summarized in Exhibit 3-1 on a dollar basis, and in Exhibit 3-2 on a percentage change basis. As we have discussed earlier in this chapter, there is probably some classification error for some of the non-multifamily units; therefore we present parallel summaries in each exhibit for all buildings and for multifamily buildings only. We believe that while the multifamily building samples are smaller samples, they are cleaner samples, since the multifamily units can be more readily identified as subject to or exempt from the D.C. rental stabilization program. We also present within each exhibit parallel tabulations for *all income* categories and just for the *L-M income* categories.

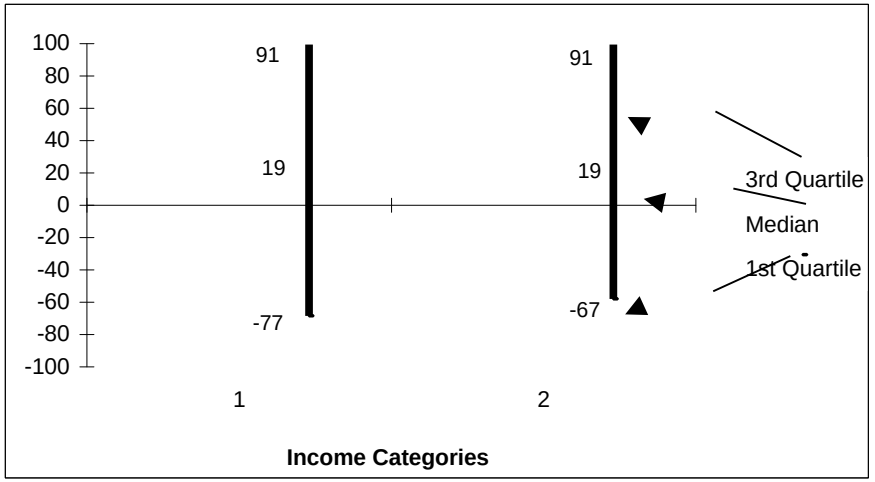
Let us focus first on Exhibit 3-1 in some detail. The two sets of results are presented — the first for all *income categories* and the second for *L-M income* categories. Within the *all income* group, the first three rows of numbers represent the third quartile, median, and first quartile of the change in monthly rent as calculated for each of the 168 sample observations, identified as controlled, and which represent at least 73,135 households in the District.[51] We see that for the *all buildings* and *all income* categories our estimate of the median change in rent is $18.60 per month. The interquartile range, or difference between third and first quartiles, is about $168.00, a fairly wide dispersion around the estimate of the median. The mean (arithmetic average) of the changes in rents is $7.90 with a corresponding standard deviation of $116.30. To the right of the tabled summary is a bar chart showing the major quartile results for each income group. Exhibit 3-2 contains the same information, for the changes in rent expressed as a percentage. As shown Exhibit 3-2, the median percent change for the *all income* group is –0.3 percent.

[51] The numbers of households reported in these exhibits and several subsequent tables are considered lower-bound estimates of the number of households. The sample weights applied to calculate these household estimates have not been modified to compensate for the sample members removed because their (1) survey records included missing values for primary characteristics, or (2) predicted values were more extreme than would be expected on a statistical basis.

Exhibit 3-1. Estimated Dollar Change in Rent from De-control, 1998

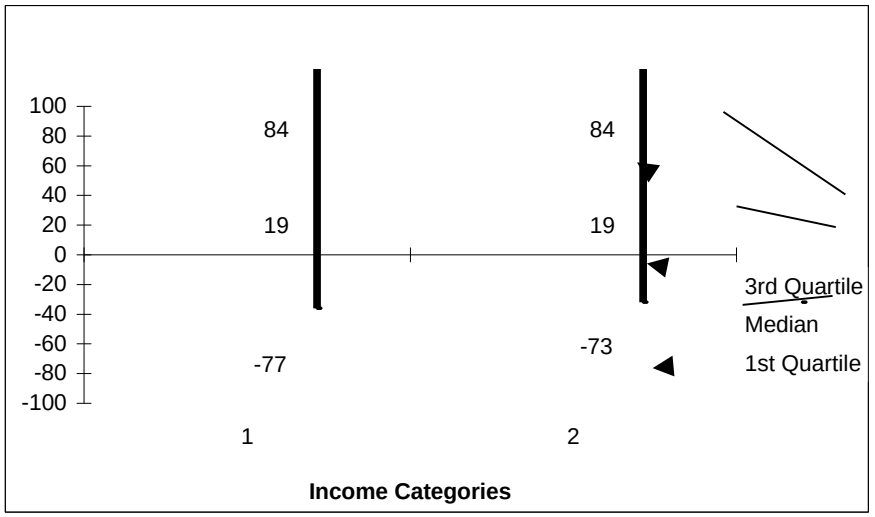
All Building Sizes

Income Categories	1: ALL	2: L-M
3rd Quartile	90.6	90.6
Median	18.6	18.6
1st Quartile	(77.4)	(66.9)
IQR	168.0	157.5
Mean	7.9	14.1
Std Dev	116.3	110.5
N	73,135	63,883
Unweighted N	168	147



Multifamily Building Sizes

Income Categories	1: ALL	2: L-M
3rd Quartile	83.8	83.8
Median	19.4	19.4
1st Quartile	(77.4)	(73.2)
IQR	161.2	157.0
Mean	5.4	6.3
Std Dev	104.6	104.5
N	43,754	38,890
Unweighted N	100	89

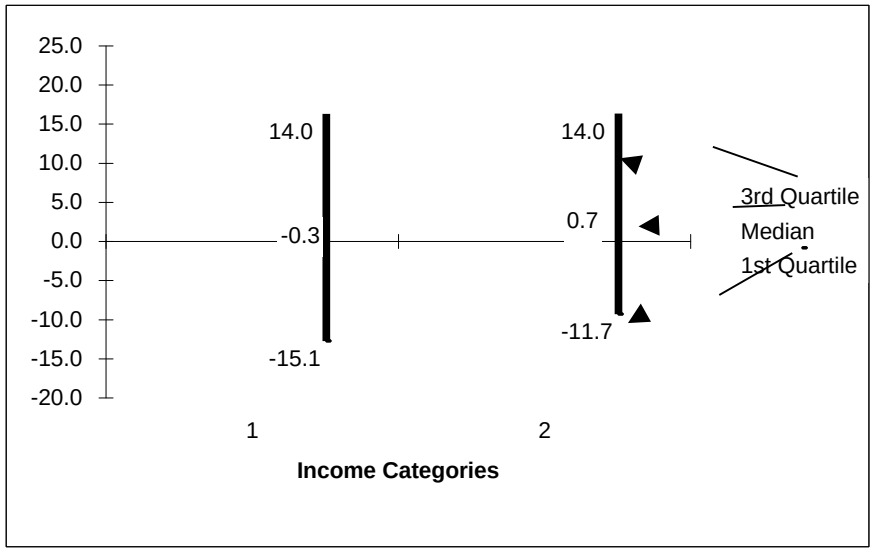


Source: Nathan Associates Inc.

Exhibit 3-2. Estimated Percentage Change in Rent from De-control, 1998

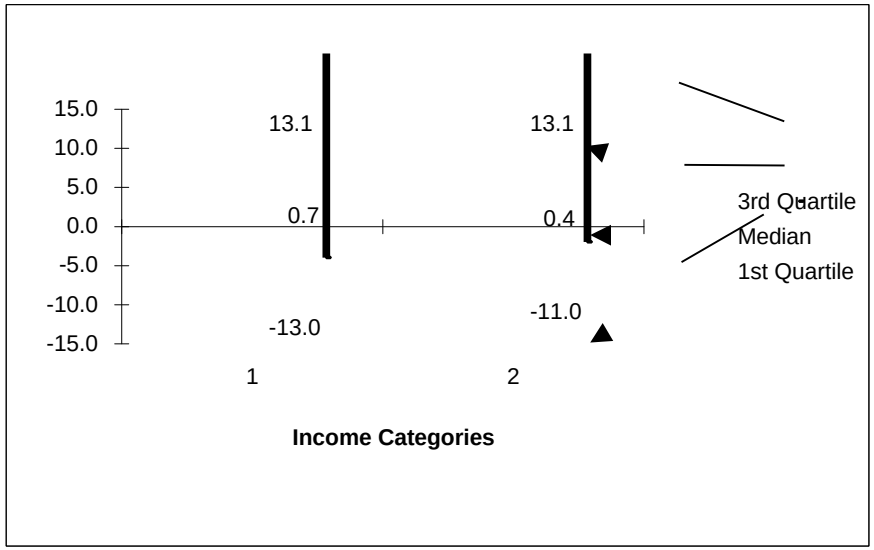
All Building Sizes

Income Categories	1: ALL	2: L-M
3rd Quartile	14.0	14.0
Median	-0.3	0.7
1st Quartile	-15.1	-11.7
IQR	29.1	25.7
Mean	0.0	2.2
Std Dev	21.6	20.3
N	77,227	63,963
Unweighted N	177	147



Multifamily Building Sizes

Income Categories	1: ALL	2: L-M
3rd Quartile	13.1	13.1
Median	0.7	0.4
1st Quartile	-13.0	-11.0
IQR	26.1	24.1
Mean	1.4	1.8
Std Dev	18.0	17.4
N	43,412	37,632
Unweighted N	99	86



Source: Nathan Associates Inc.

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As we look across the eight sets of results, the most notable features are that: (1) the changes in rents predicted for the different income groupings and building types are more similar than different, and (2) the predicted changes are very modest, if not trivial, on an aggregate basis. Several caveats are in order, however, before considering these predictions of rent changes in any detail:

1. The hedonic methodology used to estimate market rents and the changes in rents for D.C. rental stabilized units is useful for revealing broad rent patterns and for approximating average market rents. It is inappropriate to use the results of these models to provide definitive estimates of the predicted rent change for any individual rental unit if rent stabilization in the District was eliminated.
2. The hedonic models predict best for households in the middle of the housing quality distribution. Rental units at the extremes of the distribution are often outside the range of a typical unit's quality. Thus, the hedonic models do not do a very good job at representing either the superior quality of a high–end rental unit or the poor quality of a low-end rental unit.[52]
3. As stated earlier, the strict interpretation of these results as the rent changes that would be observed for D.C. rent stabilized housing units if rent stabilization were to be eliminated depends on the maintained hypothesis that the rents paid in the surrounding jurisdictions — Montgomery County, Prince George's County, the City of Alexandria, Arlington Country, and Fairfax Country — are reasonable estimates of the rents paid by District households in the absence of controls once differences in housing quality are taken into account. But also, as noted earlier, the comparison of the D.C. rental market and the rental housing market in the surrounding jurisdictions is useful even if the "but for" presumption is not met.

Interpretation and Implications

The interpretation of the hedonic results that we can outline is rather brief. An average is the mean of different values, and some are greater than the average and some are less than the average. As the average impacts of eliminating rent stabilization projected with the hedonic models are quite small, clearly rent stabilization must have a very minimal impact on the current rents for D.C. rent

[52] We believe that this specification problem could be ameliorated if sufficiently detailed quality variables were available in the AHS. One variable that seems to confirm this hypothesis is the square footage of the unit. Many of the quality variables available from the AHS are fairly discrete, such as whether or not one has a washer or whether the building has an elevator. Number of rooms is also fairly discrete. More continuous variables like square footage could be useful in solving the specification issue. Unfortunately, we found when we use square footage that only about half the units in the sample reported the value of this variable. Furthermore we discovered that the pattern of non-reporting was not random. Households who lived in lower quality units, who had lower incomes, and lower education levels, among other things were households who were less likely to report this variable. Given the fact that so few reported and that the pattern of response and non-response was far from random, we decided that we could not include this variable in our models. When the variable was included, however, the residuals for the observations at the extremes in housing quality are greatly reduced.

stabilized units. We turn to other information sources to estimate how many units would be affected and by how much their rents would increase.

Properties That Will be Affected and by How Much

Rental units in the District that are *at risk* of a rent increase with the elimination of rent stabilization are included among those with current occupants who pay rents at the ceiling rate for their unit. Currently, 17.3 percent of rent stabilized housing units in the District of Columbia rent at their ceiling rate. The monthly rent for an *at risk* housing unit would increase an average of $36.42 or 10.4 percent. Rental units most *at risk* are in larger properties. Additional housing units that are *at risk* are located in smaller multifamily properties.

The number of rental housing units that currently rent at their ceiling rates is an upper bound of the number at risk of a rent increase if the District's rent stabilization requirements are rescinded. As reported by the Urban Institute, 86 percent of rent stabilized housing units charged rents at or very near their rent ceiling in 1986.[53] Nathan Associates estimates that the percentage of rent stabilized housing units with rents at their ceiling rate was 17.3 percent at mid-1999.[54] How can the ceilings be binding on so few of the District's rent stabilized housing units and what are the likely implications for the size of the possible rent changes?

Rents and Rent Ceilings under the Rental Housing Act

Rent increases under the rent stabilization provisions of the Rental Housing Act are subject to the increases in rent ceilings permitted under the Act. The Act limits the amount and frequency of increases in rent ceilings, and the rent charged for a housing unit may be increased up to the rent ceiling of record. While rent ceilings can be increased on the basis of a number of different conditions — such as for financial hardship and capitol improvements — the principal ceiling changes that are of concern are the annual adjustment of general applicability and the vacancy adjustment.

- The general applicability standard permits an automatic increase in a unit's rent ceiling once per year, by the lesser of the percentage change in the *all items* annual Consumer Price Index

[53] Turner (1988b, 54).

[54] This estimate is based on Nathan Associates' survey of the District's rental housing providers and sampling of the rent and rent ceiling filings maintained by the D.C. Department of Consumer and Regulatory Affairs.

for Wage Earners (CPI-W) for the Washington metropolitan area published by the U.S. Bureau of Labor Statistics, or to a maximum of 10 percent of the previous authorized ceiling.

- The vacancy adjustment provisions of the Rental Housing Act permit a rent ceiling to increase by 12 percent of the previous authorized ceiling or to the ceiling of a substantially identical unit, when the current tenant vacates the rental unit.[55]

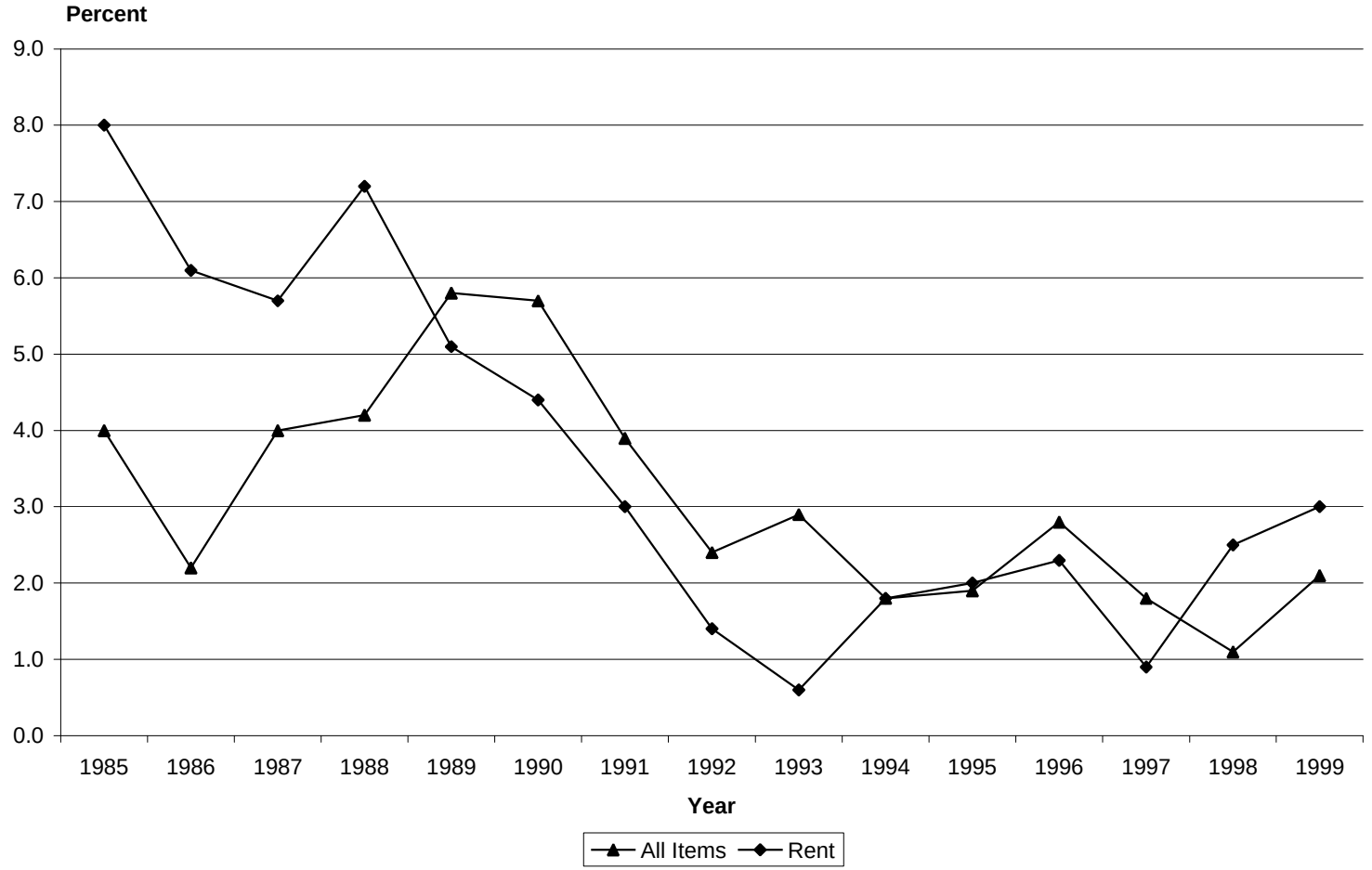
The *all items* and *residential rent* CPI-W series for the Washington, DC-MD-VA metropolitan area, 1985 through 1998, are displayed in Figure 3-2. The *all items* series is the basis for the general applicability standard for increasing ceiling rents. The *residential rent* series is included in the figure to represent the changes in rents as distinct from the changes in rent ceilings. Since the rent series is for the metropolitan area rather than for D.C. proper, it is only suggestive of the changes in rents in the District. As shown in Figure 3-2, the CPI-W for rents exceeded the all items CPI-W up to 1988, suggesting that during this period rents increased more rapidly than rent ceilings, resulting in binding rent ceilings for more rent stabilized units. The pattern changed starting in 1989, as rent ceilings increased faster than rents, and the ceilings became less binding than they had in the late 1980s. The moderation in rent increases in the District has been driven in part by the softened demand for rental housing as District residents moved to the surrounding jurisdictions.

An illustration of the relationship between rent stabilized rents and rent ceilings is set out in Figure 3-3. This hypothetical is based a monthly rent of $450 per month in 1989, the approximate median rent in the District of Columbia as reported by the 1989 AHS for the Washington metropolitan area. The rent ceilings in this illustration are assumed to be equal to the rent charged in 1989. Three trend-lines are plotted in this figure. The lowest trend-line is the path that the median rent would have followed if it changed each year according the CPI-W for residential rent for the Washington metropolitan area. The middle trend-line is the path that the ceiling rents would have followed if the tenants in 1989 had continuously maintained their occupancy and the rent ceilings had been increased only by the general applicability standard.[56] The upper trend-line incorporates the 12 percent vacancy adjustment in rent ceilings permitted by the rent stabilization provisions of the

[55] A vacancy rent ceiling adjustment cannot be used within a year of taking a hardship adjustment.

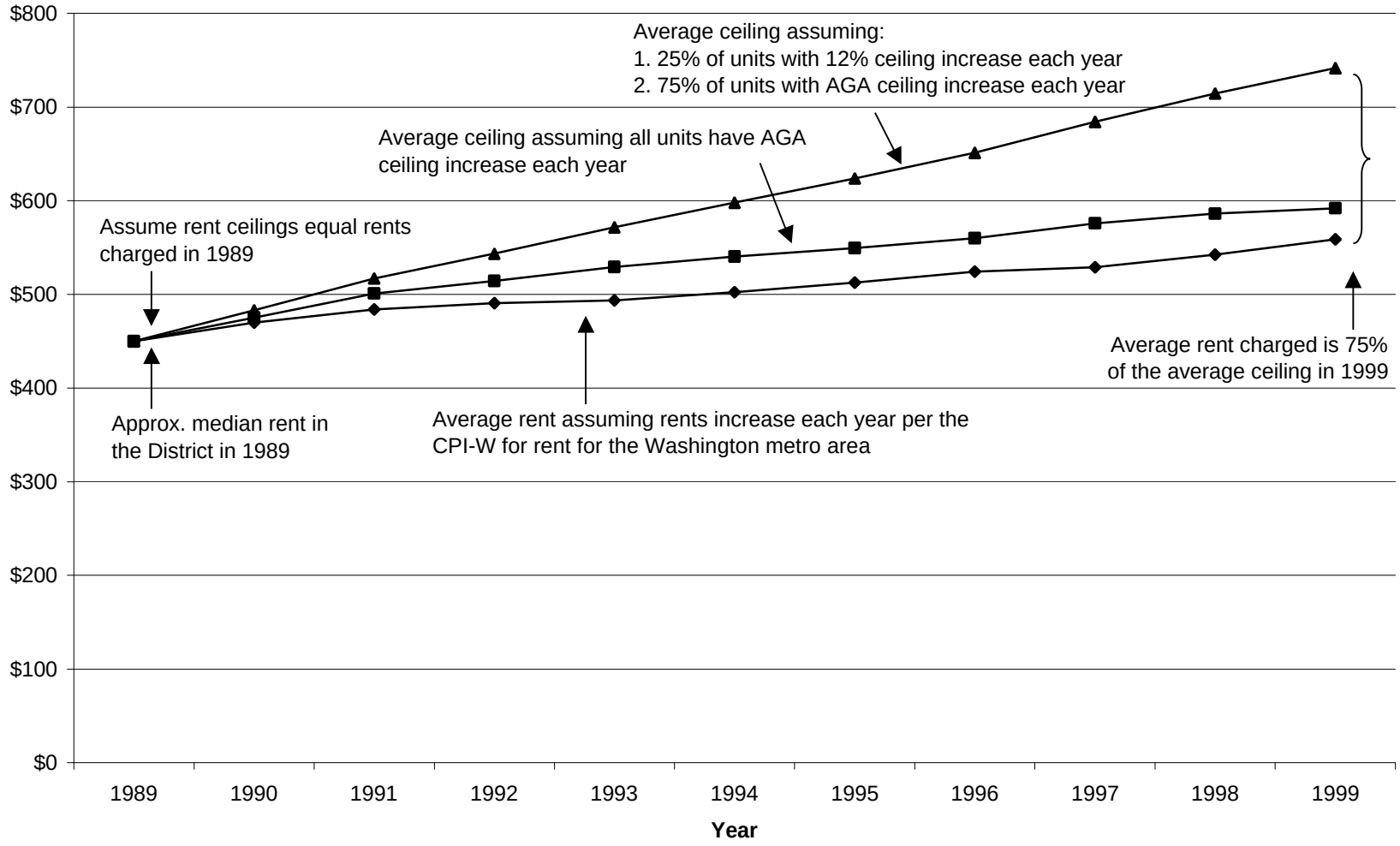
[56] The changes in the ceiling shown in Figure 3-3 differ from changes shown in Figure 3-2 for the all items CPI-W. The all items series included in Figure 3-2 is for the relevant calendar while the actual increases permitted for rent stabilized properties and incorporated into Figure 3-3 are based on the 12 months starting in May of each year.

Figure 3-2. CPI-W for All Items and Residential Rent for the Washington, DC-MD-VA Metropolitan Area, Annual Percentage Change



Note: 1998 and 1999 data are for the Washington-Baltimore, DC-MD-VA-WV area.
Source: Bureau of Labor Statistics.

Figure 3-3. Illustration of How Rent Ceilings Have Risen Faster than the Rents Charged for Rent Controlled Units in the District of Columbia



Note: AGA=adjustment of general applicability.
Source: Bureau of Labor Statistics and Bureau of the Census.

Rental Housing Act. This line is a weighted average of the general applicability standard (represented by the middle trend-line) and a 12 percent vacancy adjustment.[57] As the average rent ceiling increased with both the general applicability and vacancy adjustment, rent ceilings have become even less binding on the rents charged for rent stabilized housing units. Rent stabilized housing units that rent at their ceiling rates are likely to include units with long-term tenants. Rental housing providers may not have had an opportunity to adjust the ceiling rents for such units with the vacancy ceiling adjustment for some time. Some tenancies may even pre-date rent control in the District.

Trends in the numbers of petitions filed by landlords to raise rent ceilings for other reasons permitted by the Rental Housing Act, set out in Table 3-5, support the interpretation of the changes in rents and rent ceilings for rent stabilized housing units displayed in Figures 3-2 and 3-3. Table 3-5 covers landlord petitions filed for financial hardship, capitol improvements, substantial rehabilitation, and changes in services. As the record indicates, hardship petitions and capitol improvement petitions have dropped to fractions of their levels at the end of the 1980s. The decline in these types of landlord petitions suggests a decline in the housing providers' needs to raise rent ceilings in the 1990s.

Likely Rent Changes for Housing Units at Risk

The hedonic model-based estimates of the average rent increases for rent stabilized housing units are $5.40 to $6.30 per month, or 1.4 percent to 1.8 percent of the current monthly rent.[58] These are relatively modest changes, but do represent the average changes for the rent-stabilized portion of the District's rental housing market. Rent stabilized housing units at risk of a rent increase are among those with rents at their ceiling rate. Responses to the survey of rental housing providers indicate that 17.3 percent of rent stabilized housing units rent at their ceiling rates as of mid-1999. If the hedonic model approach does yield a reliable projection of the rents that would be charged for D.C. rent

[57] The 1989, 1993, and 1998 AHS surveys for the Washington metropolitan area reported an average of 25 percent of renter-occupied housing units in the District of Columbia have completely new tenants in the year for which they were surveyed and, therefore, 75 percent of rental units have the same occupants from one year to the next. Thus, the weighted average is calculated with a weight of 0.75 for the general applicability standard and 0.25 for the 12 percent vacancy adjustment.

[58] These average figures are for rental units in multifamily buildings.

Table 3-5. Number of Landlord Petition Filings by Type, 1988-1999

Year	Hardship	Capitol Improvement	Substantial Rehabilitation	Change in Services
1988	127	107	0	0
1989	61	105	2	1
1990	45	54	7	2
1991	38	35	4	5
1992	22	21	6	4
1993	16	24	2	2
1994	3	35	0	1
1995	5	20	1	1
1996	2	6	1	0
1997	19	5	0	1
1998	0	10	3	0
1999	0	0	1	0

Source: Tabulated by Nathan Associates or DCRA staff from DCRA records.

stabilized housing units if rent stabilization was elimination, and only 17.3 percent of the rent stabilized units are at risk of a rent increase, then the average increase for the units at risk[59] would be greater than the rent stabilized market-wide average. With these conditions and caveats, had rent stabilization been eliminated in mid-1999, the rent increases for units *at risk* would have averaged $36.42 or 10.4 percent.[60]

Properties and Rental Units at Risk as of Mid-1999

The number and distribution of rent stabilized housing units in the District that currently rent at their ceiling rates, by quadrant of the District and property size, are set out in Table 3-6. These figures were developed from the responses to the survey of rental housing providers in the District of Columbia. The distribution of these units by quadrant is similar to the distribution of all rent stabilized housing units (see Table 2-3). The distribution of units renting at their ceiling rates by property size, however, is skewed toward the smaller rental properties and away from the larger properties. The smaller rental properties account for 45.7 percent of rental units at the ceiling but only 31.5 of all rent stabilized housing units, while the larger properties account for 20.3 percent of rental units at the ceiling compared to 31.5 of all rent stabilized housing units. It appears that the owners and operators of the smaller properties have been less likely to file for rent ceiling adjustments or have experienced less tenant turnover.

The percentages of rent controlled units that rent at their ceiling rates, as shown in Table 3-7, do not vary substantially by quadrant or by the typical household income of the property. The percentages of units at their rent ceilings are marginally different by the typical annual household income of a property; the percentage of units at their rent ceilings is highest (by less than one percentage point) for properties with a typical annual household income of under $25,000 (18.3 percent), followed by properties with a typical income of $50,000 and over (18.0 percent) and

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[59] This considers all rental units renting at their ceiling rate as housing units *at risk* of a rent increase with the elimination of rent stabilization.

[60] The figures reported in the text were determined by weighting the $6.30 and 1.8 percent estimates of the average increases estimated for rent stabilized housing units from the hedonic models by 0.173, the proportion of units *at risk* of a rent increase as of mid-1999. The validity of this "back of the envelope" calculation depends on the premise that essentially only the units with rents at the ceiling would incur rent increases if rent control were repealed.

Table 3-6. Number and Percentage Distribution of Rent Controlled Units with Rents at Their Ceiling Rates, July 1999

Property Size	Quadrant				Quadrant			
	NW	NE	SE/SW	Total	NW	NE	SE/SW	Total
	--------Number of units at ceiling--------				---Percent distribution of units at ceiling---			
9 units or less	3,863	2,721	1,409	7,993	22.1	15.5	8.0	45.7
10-49 units	3,394	907	1,657	5,958	19.4	5.2	9.5	34.0
50 units or more	1,527	420	1,611	3,558	8.7	2.4	9.2	20.3
Total	8,784	4,047	4,677	17,509	50.2	23.1	26.7	100.0

Note: Percentages may not sum due to rounding.
Source: Nathan Associates Inc.

Table 3-7. Number of Controlled Units and Number of Units at Rent Ceiling by Typical Household Income of Property and Quadrant, July 1999

	Number of Units with Rent at Ceiling	Number of Controlled Units	Percent
Typical Household Income of Property			
Under $25,000	7,372	40,363	18.3
$25,000-$49,999	9,199	55,898	16.5
$50,000 and more	938	5,202	18.0
District Quadrant			
NW	8,784	53,072	16.6
NE	4,048	18,829	21.5
SE/SW	4,677	29,562	15.8
Total	17,509	101,463	17.3

Source: Nathan Associates Inc.

properties with a typical income of $25,000 to $49,999 (16.5 percent). The percentages of units at their rent ceilings differ somewhat more by quadrant, ranging from 15.8 percent in the Southeast/Southwest quadrants to 21.5 percent in the Northeast quadrant.

Given the percentage of units at their rent ceilings (17.3 percent) and the projected percentage increases in rents if rents were de-controlled (an average rent increase of 10.4 percent for units at their rent ceilings and an overall average rent increase of 1.8 percent for all controlled units), typical rent burdens for units at their ceilings and for all controlled units are not likely to increase dramatically if rent control were repealed. An example of how rent burdens may change if rents were de-controlled is shown in Table 3-8. In the illustration, the median rent burden for units at their rent ceilings would increase from 26.7 percent to 29.5 percent and the median rent burden for all controlled units would increase from 26.4 percent to 26.9 percent. Of tenants in units at their rent ceilings, the largest increases in rent burdens (in terms of the share of the tenant's income that would be consumed by the rent increase) would most likely occur for low-income households that already have the highest rent burdens when compared to higher income groups. In the example, the median rent burdens at properties with a typical annual household income of under $25,000 would increase from 35.3 percent to 39.0 percent for units at their rent ceilings and from 35.3 percent to 36.0 percent for all controlled units.

The Near-term Outlook

The percentage of units at their rent ceilings, the units that would most probably experience rent increases with de-control, will likely not change substantially over the next couple of years, because many units are well below their rent ceilings, as shown in Table 3-9. Currently, about one in five (18.9 percent) of rent controlled units have rents that are less than 50 percent of their ceilings, and 25.3 percent of the units have rents that are 50 percent to 74.9 percent of their ceilings. Also, the substantial decline in the percentage of units at their rent ceilings from 86 percent in 1986 to 17.3 percent as of mid-1999 took place over an extended time period; it would most likely take significant average rent increases (or decreases) above (or below) the overall inflation rate[61] over a several year period to substantially increase (or decrease) the percentage of units at their rent ceilings.

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[61] The annual ceiling adjustment of general applicability is based on the overall inflation rate as measured by the CPI-W for the Washington metropolitan area.

Table 3-8. Illustration of How Rent Burdens for Nonsubsidized District Tenants Could Increase If Rent Control Was Repealed

	Median Rent Burden with Rent Control[a]		Median Rent Burden without Rent Control	
	Units with Rent at Ceiling	All Controlled Units	Units with Rent at Ceiling[b]	All Controlled Units[c]
	----------Contract rent as a percent of income----------			
Typical Household Income of Property				
Under $25,000	35.3	35.3	39.0	36.0
$25,000-$49,999	21.2	21.2	23.4	21.6
$50,000 and more	12.9	12.9	14.2	13.1
District Quadrant				
NW	24.8	23.8	27.4	24.2
NE	27.6	29.8	30.5	30.4
SE/SW	29.4	28.7	32.5	29.2
Total	26.7	26.4	29.5	26.9

Note: Rent burden is defined as contract rent as a percent of income.

[a] The median rent burdens of nonsubsidized District tenants by annual household income (35.3% for incomes under $25,000; 21.2% for incomes $25,000-$49,999; 12.9% for incomes $50,000 or more) were tabulated from the 1998 American Housing Survey for the Washington Metropolitan Area. The median rent burdens by quadrant were approximated using the median rent burdens in this table by typical property household income and the number of units at their rent ceilings and the number of controlled units by typical property household income and quadrant.

[b] The median rent burdens without rent control of tenants in units where the rents are at their ceiling rates were derived by increasing the median rent burdens under rent control by the projected average rent increase of 10.4 percent.

[c] The median rent burdens without rent control for all controlled units were derived assuming that if rent control was repealed, rents would not increase for units where rents are below their ceiling rates.

Source: Nathan Associates Inc.

Table 3-9. Differences between Rent Ceilings and Rents Charged, July 1999

Rent charged is:	Number of Controlled Units	Percent
At the rent ceiling	17,509	17.3
90% to 99.9% of the ceiling	14,073	13.9
75% to 89.9% of the ceiling	25,041	24.7
50% to 74.9% of the ceiling	25,640	25.3
Less than 50% of the ceiling	19,200	18.9
Total	101,463	100.0

Note: Percentages may not sum due to rounding.
Source: Nathan Associates Inc.

Closing Remarks

Estimates of the rent increases that are likely to occur with the elimination of rent control in D.C. were presented in this chapter. The average change in rent is estimated to be in the range of $5.40 to $6.30 or 1.4 to 1.8 percent of monthly gross rent. Rent ceilings are binding, however, for only 17.3 percent of the District's housing units subject to rent stabilization. If current market conditions continue, the average increase in rent for the 17.3 percent of housing units at risk of an increase is estimated to be $36.42 or 10.4 percent per month. The next chapter present the results of our projections of the likely impacts of rent de-control on the stock of D.C. rental housing.

4. Likely Impacts of Rent De-control on Rental Housing

Rents in the District of Columbia, as in any market, serve to compensate owners of existing housing units for the investment and operating costs of providing shelter to a segment of the population. Rents also represent the price signal to current and prospective property owners for the type, level, and location of resources that should be invested in a market at any point in time. Rent control, like any price control, may result in rents being lower than the market-clearing price of rental housing. Terminating rent control should reverse the process and result in an increase in the price charged for rental accommodations. Lifting price controls should also expand the supply and quality of rental housing. In Chapter 3 we reported our findings that average rent increases are likely to be very modest if the District of Columbia were to rescind rent control in today's economic environment. In this chapter we report the likely responses by rental housing providers, in terms of the supply of rental housing and additional investment in rental housing, to the tenant impacts we have projected.

Nathan Associates concludes that it is unlikely that a significant supply and investment response would be forthcoming from rental housing owners and operators to the elimination of rent stabilization. Rental housing providers appear prepared to be quite responsive, in terms of increased maintenance and capital improvements, to an average rent increase as low as 5 percent with the elimination of rent stabilization. At the same time, however, they report that the provisions of the Rental Housing Act other than rent stabilization requirements have as strong effects on their properties' revenue and costs as do the rent stabilization provisions of the law.

This chapter of our report is concerned with the likely supply and investment responses by rental housing providers to the elimination of rent control in the District of Columbia. The first section of this chapter presents a qualitative model that links the market for the use of real estate with the market for investment in real estate. The effects of rent control and de-control are explained in reference to the linkages evident in this paradigm. Second, we present and discuss the likely responses of D.C. rental housing providers to eliminating rent control. The likely responses by rental housing providers were solicited by the survey conducted for this purpose.

Impacts of De-control on Supply and Investment: in Theory

The direct impacts of rent de-control on tenants were explained in Chapter 3 with a simplified theoretical model of supply and demand in the real estate *property* market. The *property* market is the market for the *use* of real estate. In the property market, the supply of housing (a *use* of real estate) is fixed in the short-run and treated as a given. The supply of housing is determined in the real estate *asset* market — the market for *investment* in real estate assets. The discussion that follows describes the two real estate markets and their inter-connections. The conception of the two-market model that forms the basis of this discussion was developed by Denise DiPasquale and William C. Wheaton and is referred to in the real estate economics literature as the 4 Quadrant Model or 4QM. The effects of rent control, and de-control, on supply and investment are then discussed with reference to the mechanics and interactions with and between the property and asset markets.

Real Estate Asset and Property Markets[62]

The distinction between real estate as space and real estate as an asset is quite clear when tenants rather than their owners occupy space (property). Tenant requirements, and the available types and quality of buildings and properties, determine the rent for space in the market for property use. At the same time, buildings and properties may be bought, sold, or exchanged in the investment market for rental real estate. Such transactions take place in the capital asset market and determine the asset price of real estate (and the price of an asset reflects its value).

In the real estate investment market, the demand to own real estate assets must equal their supply. The price or value of real estate, like an apartment complex, depends on how many investors want to own such property and how many apartment complexes there are to invest in. As would be expected in most typical markets, an increase in the demand to own real estate all else being equal, will raise prices, while a greater supply will depress prices.

The supply of new real estate is produced in the development (or construction) sector, and depends on the price (value) of those assets relative to the cost of replacing or constructing them. In the long-run, the asset market should equate market prices with replacement/construction costs (including the cost of land). Market prices and replacement costs, however, may differ in the short-

[62] The discussion presented here is derived in its entirety from DiPasquale and Wheaton (1996, 6-10).

run because of the lags and delays inherent in the construction process. Competition in the investment market will drive up demand and, with it, the price (value) of real estate assets. New development takes place when the value of a property exceeds its cost of construction. As new space arrives in the investment market it becomes absorbed, satisfying the demand for assets. In turn, the price in the investment market adjusts back to the level where price just equals replacement cost.

An increase in the demand for real estate assets in the investment market is a response to the competition of investors bidding up asset prices. The rental income real estate assets earn is an important determinant of the demand for investment assets. Rent, the price charged to consumers in the property market, is determined in the market for the use of property. In the property market for rental housing, the demand comes from the tenants who occupy and use space. Households use their income to consume many commodities, only one (but a very significant one) is their living space. The household demand for living space depends on income and the cost of occupying the space relative to the cost of other commodities, like food, clothing, or entertainment. The cost of occupying space is the necessary periodic rent paid to obtain the use of real estate.

Rent is determined in the property market for space use, not in the asset market for ownership. In the property market the supply of space is a given and fixed in the short-run. The demand for the use of real estate depends on rent and other economic factors that are external to the real estate market, such the number of households seeking rental accommodations and their income levels. The property market determines the market clearing rent at the level at which the demand for space equals the supply of space. Holding everything else constant, an increase in the number of households seeking rental accommodations will increase the demand for space use. Rents rise as well with fixed supply.

As rental income is an important determinant of demand in the market for real estate investment, we have now traveled a full circle — from the property market to the investment market, from the investment market to the development market, development determining the supply of real estate to the property market, and rents in the property market shaping demand in the investment market. The asset market and the property market are linked with two inter-connections. At the first juncture, rent levels determined in the property market are driving forces shaping demand in the investment market since investors are purchasing a current or future stream of income in acquiring an asset. Changes in rent occurring in the property market, therefore, immediately affect the demand for ownership in the asset market. The second link between the markets occurs through the development (or construction)

sector. If development increases and the supply of assets grows, not only are prices driven down in the asset market, but rents decline as well in the property market.

The elements of the property and investment markets and their inter-relationships are highlighted in the diagram presented in Figure 4-1. The property market is on the left and the asset market is on the right. Each element is numbered (e.g., I, II, etc.) to help follow this presentation. We begin in the property market, in I. RENT DETERMINATION (upper-left), where rents are determined.[63] The demand curve for rental property is a schedule of the rents that households are willing to expend for living space for the varieties of accommodations offered in the market. The inventory of space available for occupancy is fixed in the short-run and, therefore, household demand establishes the level of rents. Rent is determined where demand equals the available inventory. Demand can move along the demand curve; it can adjust up with a sudden influx of new residents, and it can adjust down with changes in economic conditions. Changes in housing preferences can also alter the rent/space tradeoff for individual households.

II. ASSET VALUATION (upper-right) represents the first part of the asset market, and it is here that rent is taken from the property market (I.) to determine the price (value) of real estate assets based on the expected return on the investment in the property. The relationship between the rental income from a property and its value in the investment market, the ratio of rent–to-price, is the current yield (return) that investors demand in order to hold real estate assets.[64] Current yields are influenced by four factors: (1) the long-term interest rate in the economy, representing conservative returns for alternative uses of the investor's financial resources; (2) the expected growth in rents; (3) the risks associated with the property's rental income stream; and (4) the treatment of real estate in the federal tax codes.

New assets are created by the construction sector, represented by III. DEVELOPMENT OF NEW ASSETS. (lower-right) The construction sector produces new additions to the inventory of real estate. New construction is undertaken when the value of investment property rises with increased demand and property values exceed the costs of replacement construction. Construction bottlenecks,

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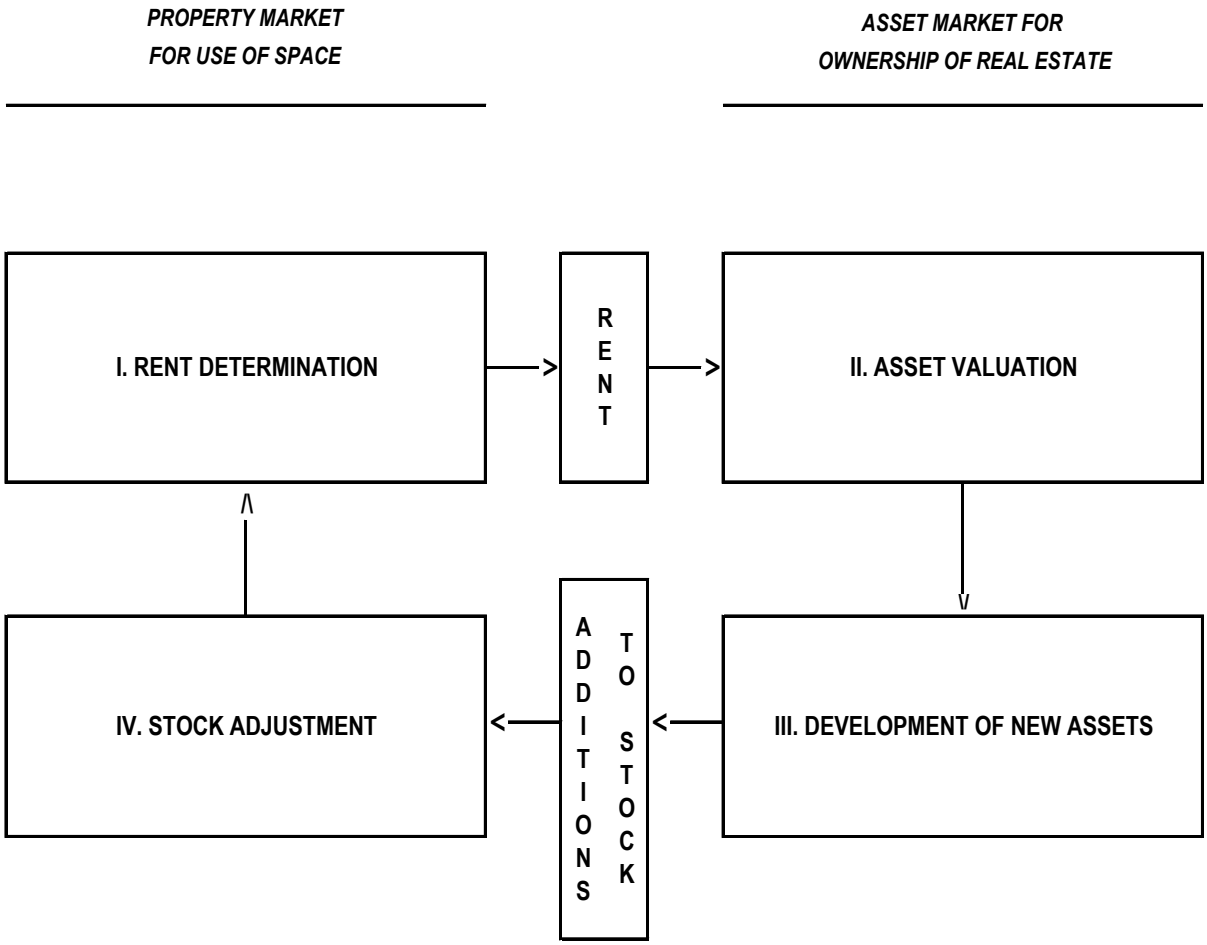
[63] The constraint imposed by a rent ceiling on supply and demand in the property market is the basis for the theoretical effects of rent de-control on tenants discussed in Chapter 3.

[64] The ratio of rent-to-price is commonly referred to as the capitalization rate or cap rate.

Figure 4-1. Markets for Real Estate Use and Real Estate Assets



scarce land, and other impediments to development reduce the responsiveness of the construction sector to an increase in demand and property values.

The stock adjustment in IV. (lower-left) converts the annual flow of new construction into the long-run stock of real estate space. The change in stock is a given period is the new construction less (minus) losses from the stock from removal and depreciation. A certain level of construction is necessary to maintain the stock of space by compensating for depreciated and abandoned properties. The adjustment in the stock of space brings us full-circle to rent determination in the upper-right property market.

Rent Control in the Context of Property and Asset Markets

Rent control affects both the property (use) market for rental space and the asset (investment demand) market for the same. In general, the effect controls have on the elements in each of the real estate markets will be comprised of two effects: a direct effect from a change in the relationships at work in each element; and a second effect from the lowering of rents by the imposition of rent ceilings.

In II. ASSET VALUATION, representing asset demand by investors, binding rent controls reduce average returns, and particularly truncate expected returns to investment. At the same time, uncertainty over future regulation adds to the increased risk to investment, driving up yields,[65] implying that the value of rental housing unit commanding a particular net rental stream will fall. In addition, since rents will fall, values are hit with a double whammy. Yields rise at the same time rents fall compounding the falling value.

Rent control also affects the supply side of the rental housing market in III. DEVELOPMENT OF NEW ASSETS. The first effect of controls on the production of new properties is to retard the response of the development sector to changes in property values. That is to say, for any value that housing commands in the asset marketplace, a smaller supply response will be observed. Many other regulations in place in the District contribute to the responsiveness of the development sector. Restrictive zoning, building codes, lead abatement rules, and other regulations impose costs on

[65] This effect is discussed in some detail, and studied with simulation methods, in Malpezzi (1999a).

development, redevelopment and conversion above and beyond the costs of land and construction.[66] In these events, regulating development leads to a reduction in the response of supply that compounds the shift due to rent control (and other rental regulations, such as extraordinary tenure security). There is also a second effect. Since values fall from rent control's effects in the market for investments (II. ASSET VALUATION), development declines for two reasons: one is change in response from property developers, and the other is the reduction in value of renter-occupied housing.

Rent control also affects the depreciation of the stock of rental property in IV. STOCK ADJUSTMENT. Theoretical and empirical studies suggest that controls will generally increase the depreciation of the housing stock because of reduced incentives for maintenance by landlords.[67] As in the other market elements, rent controls affect stock adjustments in two ways. At the same time the flow of newly constructed stock is constrained in the development sector. Increased losses and reduced new additions add up to shrinkage in the stock of rental space.

Rent control does not affect the demand for housing *per se*, in the property market (I. RENT DETERMINATION). As a price ceiling, however, binding rent controls that result in lower rents cause households to move *along* the demand curve.

In summary, the property and asset markets paradigm helps highlight several important concerns with rent controls. By accelerating depreciation, raising cap rates (lowering property values relative to rents), and slowing the construction/development side of the asset market, rent control pushes *equilibrium* rents higher. Given the asset market and depreciation effects of controls, the rent at which landlords and tenants would settle on the same rent would actually increase, although the intended effect of controls is to *mandate* a decrease, thereby leading to a disequilibrium in the housing market.

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[66] Of course regulations confer benefits as well as costs. Regulations that impose large costs for little benefit are prime candidates for reform. Holland & Knight (1998) discuss some of these regulatory issues in the D.C. context, and Malpezzi (1999b) discusses them in a more general context.

[67] See for example Dildine and Massey (1974). But see Olsen (1994) for analysis of a particular case where controls could theoretically increase housing maintenance. This counter-intuitive result is possible in markets where controlling authorities constantly monitor the quality of housing services produced by a controlled unit, and adjust rents according to maintenance behavior. It is hard to think of a rent control regime that works this way in practice, and it is certainly not the case with the District's rent control.

Thus, if these effects on property values and the development of new properties are substantial, the gap between equilibrium rents and rents legally obtainable under rent control may be surprisingly large. While the qualitative results of the analysis are well founded, it is the magnitudes of the effects that matter. Whether or not the changes in the supply function and valuation are substantial remains to be determined.

It also worth repeating that the District has a number of regulations besides rent control that can have unfavorable effects on both property and asset markets. Unnecessary delays and uncertainties in obtaining approval for reasonable projects, and extremely strong tenant eviction protections, can have the same qualitative effects in these markets as controls.

Supply and Investment Effects of Eliminating Rent Control

The effects of eliminating rent control can be examined with the property and asset markets model by following the reasoning of the last several pages in reverse. According to this model, the repeal of rent control would be accompanied by effects on all four elements that would be the mirror images of those just discussed.

Asset values would rise, as investment in rental housing becomes less risky and more desirable. The rate of depreciation would fall, as landlords were able to recover returns to such investments. As property values rise, the removal of controls would also generally improve the responsiveness of the construction/development sector with both new construction and rehabilitation. We reiterate, however, that rent control is only one of many regulations that can reduce the responsiveness of the supply side of the housing market. The elimination of rent control cannot overcome the collateral impacts of other regulatory requirements. Along with these other changes actual rents paid would rise, but equilibrium rents would fall. That is to say, the disequilibrium difference between the rents landlords offer and those tenants are willing to pay would shrink.

Once again we must reiterate that the conclusions from this model are qualitative and not quantitative in nature. How large the rent changes, investment risk reductions, depreciation rate reductions, or increased responsiveness in new building activity would be, depends on market conditions including other regulatory regimes as well as the exact form of the rent control system.

How Rental Housing Providers Would Respond

What would be the likely relative magnitudes of these changes in the supply of and investment in rental housing in the District? Precise forecasts are impossible to obtain, but we have the basis for a qualitative forecast. From our empirical work discussed Chapter 3, average rents for rent stabilized housing are not much lower with rent controls then they would be with out them. This is a result of the interaction of several factors: (1) the relative generosity of permitted rent control increases under the District's laws, and (2) the decline in the number of households in the District. We expect that supply and investment responses will be minimal with the relatively small portion of rent stabilized housing for which controls are binding, increased vacancies, and other rental housing and development regulatory regimes.

Through our survey of District rental housing providers we estimated that 17.3 percent of rent stabilized housing units had rents at their ceiling rates.[68] So-called *ceiling rate* rental units are located throughout the District and in properties of all sizes. The direct effects of eliminating rent stabilization on the supply of rental housing and investment in rental housing assets are likely to be limited since a relatively small portion of the rental housing market could be affected. In Table 4-1 we present estimates of the total numbers of the units at properties that are *with* and *without* housing units renting at their ceiling rates. Table 4-1 also includes estimates of the numbers and distributions of the rent stabilized properties in the District that are *with* and *without* units that rent at their ceiling rate. These figures indicate that the total number of housing units at properties with *ceiling rate* housing units account for 50 percent of all rent stabilized housing in the District. They also indicate that properties with *ceiling rate* units account for only 41 percent of the District's stock of rent stabilized properties. These conditions would constrain the effects of eliminating rent stabilization on housing supply and investment.

The coincident regulations of the housing, development and allied sectors can have a significant influence on the ability of the rental housing market to realize the supply and investment effects of eliminating rent control. Our survey of rental housing providers solicited their opinions of the relative effects the rent stabilization provisions of the Rental Housing Acts had on their property, in terms of

[68] See Chapter 3, Table 3-7.

Table 4-1. Rent Controlled Properties with and without Units at the Ceiling, July 1999

	Units by Quadrant				Properties by Quadrant			
	NW	NE	SE/SW	Total	NW	NE	SE/SW	Total
	Number of units				Number of properties			
Properties with Units at Ceiling								
9 units or less	5,445	4,235	2,157	11,837	2,116	1,394	961	4,471
10-49 units	9,007	3,212	6,254	18,473	346	146	377	869
50 units or more	13,725	2,122	4,792	20,639	150	28	37	215
Total	28,177	9,569	13,203	50,949	2,612	1,568	1,375	5,555
Properties with No Units at Ceiling								
9 units or less	6,585	7,028	6,471	20,084	2,987	2,478	1,709	7,174
10-49 units	4,426	1,892	9,190	15,508	267	87	523	877
50 units or more	13,884	340	698	14,922	62	5	6	73
Total	24,895	9,260	16,359	50,514	3,316	2,570	2,238	8,124
All Properties								
9 units or less	12,030	11,263	8,628	31,921	5,103	3,872	2,670	11,645
10-49 units	13,433	5,104	15,444	33,981	613	233	900	1,746
50 units or more	27,609	2,462	5,490	35,561	212	33	43	288
Total	53,072	18,829	29,562	101,463	5,928	4,138	3,613	13,679
	Percent of units				Percent of properties			
9 Units or Less								
Properties with units at ceiling	45.3	37.6	25.0	37.1	41.5	36.0	36.0	38.4
Properties with **no** units at ceiling	54.7	62.4	75.0	62.9	58.5	64.0	64.0	61.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
10-49 Units								
Properties with units at ceiling	67.1	62.9	40.5	54.4	56.4	62.7	41.9	49.8
Properties with **no** units at ceiling	32.9	37.1	59.5	45.6	43.6	37.3	58.1	50.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
50 Units or More								
Properties with units at ceiling	49.7	86.2	87.3	58.0	70.8	84.8	86.0	74.7
Properties with **no** units at ceiling	50.3	13.8	12.7	42.0	29.2	15.2	14.0	25.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total								
Properties with units at ceiling	53.1	50.8	44.7	50.2	44.1	37.9	38.1	40.6
Properties with **no** units at ceiling	46.9	49.2	55.3	49.8	55.9	62.1	61.9	59.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Percentages may not sum due to rounding.
Source: Nathan Associates Inc.

lower revenue and higher costs, *vis à vis* the *other* provisions of the Rental Housing Act such as:

- Tenant protections in the event of eviction due to tenant behavior (for example, unpaid or delinquent rent, breach of contract, etc.),
- Tenant protections in the event of eviction for recovery of unit for personal use, sale or renovation, and
- Tenant rights to petition for proceedings in the event of reduction in services or facilities, or retaliatory action by landlords.

The housing providers' responses are summarized in Table 4-2. Landlords of the District's rent stabilized housing report that both the rent stabilization provisions of the D.C. rental housing law and the *other* provisions of the law affect their properties through lower revenue and higher costs. It should not be surprising that given the current state of the rental housing market, and the relatively low incidence of binding rent ceiling, that landlords report that the *other* provisions of the law have a greater effect on their properties than the rent stabilization provisions of the law. The implication is that the District's collateral regulations could block the possible supply and investment effects that could result from eliminating rent stabilization.[69]

Average rents for rent stabilized housing would be not much higher without rent controls then they would be with them. The market-wide rent increase with the elimination of rent stabilization is expected to be less than 2 percent according to the hedonic price analyses. It seems unlikely that such a meager average increase would result in significant supply and investment responses on the part of rental housing owners and operators. We asked rental housing providers how their properties would be affected, in terms of net operating income, capital improvement expenses, and routine maintenance expenses, if the elimination of rent stabilization resulted in an average rent increase for their properties of 5 percent or 10 percent or 15 percent. We also asked how ending rent control would change the salability of their property. The housing providers' responses to the hypothetical questions are summarized in Table 4-3. The figures in Table 4-3 show that the diversity characteristic of the District's rental housing market is not as strong in terms of their responses as it is with the other survey results incorporated into this report. While variations do exist by property size and

[69] Other real estate-related regulations (such as those pertaining to zoning, building permits, and the sale and conversion of rental housing for example) could similarly dampen the responsiveness of property developers to otherwise favorable market conditions.

Table 4-2. The Effects of the D.C. Rental Housing Act on Rent Controlled Properties in Terms of Lower Revenue and Higher Costs as Reported by Housing Providers, July 1999 (Percentage of Units)

Property Size/ Strength of Effect	Rent Control Provisions				Other Provisions			
	Quadrant				Quadrant			
	NW	NE	SE/SW	Total	NW	NE	SE/SW	Total
9 Units or Less								
Strong effect	50.4	16.0	45.5	37.0	45.7	43.2	60.4	48.8
An effect	78.7	80.0	91.0	82.5	80.4	94.4	97.8	90.0
No effect	21.3	20.0	9.0	17.5	19.6	5.6	2.2	10.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
10-49 Units								
Strong effect	45.9	42.5	41.9	43.6	37.2	51.0	58.9	49.1
An effect	90.0	91.5	84.5	87.7	87.4	94.9	86.6	88.2
No effect	10.0	8.5	15.5	12.3	12.6	5.1	13.4	11.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
50 Units or More								
Strong effect	3.4	31.2	20.3	8.0	10.8	0.0	18.7	11.3
An effect	76.8	100.0	86.2	79.8	82.8	86.2	86.2	83.6
No effect	23.2	0.0	13.8	20.2	17.2	13.8	13.8	16.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total								
Strong effect	24.8	25.2	39.0	29.0	25.4	39.7	51.9	35.8
An effect	80.6	85.7	86.7	83.3	83.4	93.5	89.8	87.2
No effect	19.4	14.3	13.3	16.7	16.6	6.5	10.2	12.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Percentages may not sum due to rounding.
Source: Nathan Associates Inc.

Table 4-3. Percentage of Rent Controlled Properties (Weighted by Units) Reporting that the Net Operating Income, Capital Improvement and Maintenance Expenses, and Property Salability of the Rental Property Would Increase If Rent Control Was Repealed and Average Rents Increased, July 1999

		Quadrant											
		NW			NE			SE/SW			Total		
		Average Rent Increase			Average Rent Increase			Average Rent Increase			Average Rent Increase		
Property Size	Item	5%	10%	15%	5%	10%	15%	5%	10%	15%	5%	10%	15%
9 units or less	Net operating income	77.0	87.8	80.9	86.5	100.0	100.0	74.5	83.5	80.3	79.7	90.9	87.5
	Capital improvement expenses	42.2	62.6	73.5	73.9	89.2	98.3	68.1	78.8	74.6	60.4	76.4	82.6
	Routine maintenance expenses	24.2	43.5	52.8	39.7	69.2	79.4	52.9	65.7	62.5	37.4	58.6	64.8
	Salability of property	63.2	80.3	79.0	86.0	82.6	83.5	88.3	71.8	85.9	78.0	78.8	82.5
10-49 units	Net operating income	80.8	92.6	92.4	100.0	100.0	100.0	71.3	85.6	83.5	79.3	90.6	89.5
	Capital improvement expenses	67.5	85.6	85.9	58.5	88.0	92.3	55.6	73.2	81.4	60.8	80.4	84.8
	Routine maintenance expenses	49.6	55.6	56.5	33.1	66.7	57.6	52.2	74.5	74.2	48.3	65.8	64.7
	Salability of property	81.0	84.7	88.3	68.1	67.6	70.6	77.4	84.1	75.3	77.4	81.9	79.7
50 units or more	Net operating income	97.4	97.2	99.8	86.2	86.2	86.2	56.3	100.0	100.0	90.2	96.9	98.9
	Capital improvement expenses	77.0	92.1	91.9	10.3	39.6	39.6	68.8	79.8	79.4	71.1	86.6	86.4
	Routine maintenance expenses	28.0	63.7	63.7	10.3	10.3	10.3	79.4	79.8	68.8	34.7	62.5	60.8
	Salability of property	61.7	92.3	92.2	60.4	82.3	90.9	71.7	100.0	100.0	63.2	92.8	93.3
Total	Net operating income	88.5	93.9	93.7	90.1	98.2	98.2	69.4	87.7	85.6	83.3	92.9	92.2
	Capital improvement expenses	66.7	83.8	86.2	61.4	82.4	89.0	61.7	76.1	79.1	64.3	81.3	84.7
	Routine maintenance expenses	32.6	57.1	59.4	34.0	60.8	64.5	57.5	72.9	69.8	40.1	62.4	63.4
	Salability of property	66.9	87.7	88.2	77.8	78.5	81.0	79.5	83.5	83.0	72.6	84.7	85.3

Note: Percentages for a given quadrant and property size may not be based on the exact same group of respondents.

Source: Nathan Associates Inc.

quadrant, housing providers appear prepared to be quite responsive to an average rent increase as low as 5 percent, and only somewhat more responsive to average increases of 10 percent or 15 percent.

Closing Remarks

The likely supply and investment responses of D.C. rental housing providers to the elimination of rent control in the District were presented in this chapter. A qualitative model linking the market for the use of real estate property with the market for real estate investments was presented and extended to explain the probable affects of eliminating rent control. Responses to our survey of rental housing providers indicate that landlords appear prepared to be quite responsive, in terms of increased maintenance and capital improvements, to an average rent increase as low as 5 percent. Rental housing providers also reported that the provisions of the Rental Housing Act other than rent stabilization requirements have as strong effects on their properties' revenue and costs as do the rent stabilization provisions of the law. As the average rent increase for rent stabilized housing units is estimated to be less than 2 percent (See Chapter 3) it seems unlikely that a significant supply and investment response would be forthcoming from rental housing owners and operators. A summary of the findings and conclusions of this study are presented in the next and final chapter of this report.

5. Conclusions

The federally mandated study of potential regulatory reforms for the District of Columbia (the Holland & Knight study) recommended that the Authority give serious consideration to eliminating or substantially reducing the requirements of the rent stabilization provisions of the District's Rental Housing Act on rental housing providers. Rent control is a controversial issue and one that affects many residents of the District, especially low- and moderate-income residents. For these reasons, the Holland & Knight study team also recommended that the complete elimination of rent control be postponed until a study of the likely economic and social impacts of eliminating rent control on District residents is completed. The present volume is the report of the impact study prepared by Nathan Associates Inc.

This impact study was commissioned by the Authority to answer the following questions:

- If rent ceilings are eliminated, will existing tenants be displaced because landlords will have a financial incentive to rehabilitate and upgrade existing rental properties?
- How high will rents increase for existing and new tenants with the elimination of rent ceilings?
- Will rental property developers invest in affordable housing for low- and moderate-income tenants if the possibility of future rent regulation is eliminated?
- What can be learned from the experiences of tenants in other jurisdictions that have eliminated rent control?

The findings from the research and analysis undertaken to respond to these questions are presented in this report.

The effects of eliminating rent control on tenants and rental housing depend to a large degree on conditions in the housing market at the time regulatory changes would take place. The current market context for the District of Columbia is characterized by vacancy rates for rental housing that have been elevated by the loss of population earlier in this decade. Contributing to current market conditions is the relative generosity of the rent ceiling increases that are permitted by the District's regulations that implement the rent stabilization provisions of the Rental Housing Act.

At this time, the monthly rent for only 17 percent of rent stabilized housing units in the District are at their ceiling rates and, therefore, relatively few tenants would be at risk of a rent increase with the elimination of the District's rent stabilization program. The percentages of units at their rent ceilings by quadrant are 16.6 percent in the Northwest, 21.5 percent in the Northeast, and 15.8 percent in the Southeast/Southwest. The percentages of units at their rent ceilings by the typical household income of the property are 18.3 percent for a property with a typical household income of under $25,000, 16.5 percent for a property with a typical household income of $25,000 to $49,999, and 18.0 percent for a property with a typical household income of $50,000 or more. Of tenants in units at their rent ceilings, the largest increases in rent burdens (in terms of the share of the tenant's income that would be consumed by the rent increase) would most likely occur for low-income households that already have the highest rent burdens when compared to higher income groups. The percentage of units at their rent ceilings, the units that would most probably experience rent increases with de-control, will likely not change substantially over the next couple of years, because many units are well below their rent ceilings.

The hedonic price index analysis undertaken for this study estimated that the average rent increase for the District's rent stabilized housing with the elimination of rent control would be less than $20 per month, or less than 2 percent of monthly rent, if rent stabilization had been eliminated in 1993. If rent increases for the ceiling-rate housing units are responsible for the entire market-wide average increase, then rent increases for the tenants of those housing units at risk would experience average increases of $56 or 8.2 percent month. Eventual occupancy turnover would result in some of these rent increases even with the continuation of rent control.

The District can also anticipate minor impacts from eliminating rent stabilization on the supply of affordable housing and on future investment in affordable housing if current market conditions continue. The rent increases projected for this study are just too modest to stimulate much displacement of sitting tenants. In addition, it is difficult to imagine much of a response from the development community with new or substantially rehabilitated affordable housing with the elimination of rent stabilization given current market conditions. Furthermore, while rents rose substantially in Cambridge, MA, and other Boston-area jurisdictions with the elimination of rent control in 1996, it is highly unlikely that the

District's renters would face the same experiences. Current market conditions in Washington, D.C., stand in stark contrast to the strong demand for rental housing driven by high incomes and low vacancies, that characterized the Boston metropolitan area at the time Massachusetts eliminated rent control.

Concluding Remarks

The Authority now faces a fundamental question. Given that our best estimates are that rent control's current effects in the District of Columbia are minimal, why reform at all? After all, if controls are not binding on the rents of most District rental units and the supply of rental housing at least for the low and middle segments of the market appears sufficient, why reform controls now?

A central paradox of rent control is that when controls *are* heavily binding on many units, removal or relaxation becomes politically much more difficult. Behind that paradox lies the reality that when controls are so heavily binding, more tenants are harmed in the short run by de-control. Rents can rise rapidly under such conditions, and can even overshoot long run equilibrium levels, imposing significant costs on tenants who have to adjust to a radical change quite quickly. Those adverse conditions are not in effect today, but they could very well be at some point in the future.

Eliminating rent control or instituting other significant reforms now would not lead to much of a general increase in rents, although certainly some individual tenants would see substantial increases; nor would it necessarily lead to much immediate increase in supply. Rather, reform today would be an investment for the future. If the number of District rental households increases substantially in the future, rents will increase significantly in the short-term, if left to the market. Any careful analysis of national data confirms, however, that such rent increases are generally moderated within a few years as supply catches up to demand. But if binding controls impede this market signal, the supply response will not be forthcoming.

There are other costs of controls, such as the administrative costs (which probably are heaviest per unit on medium sized landlords) and elevated capitalization rates that reflect higher risk, that also impede signaling and market response. All in all, however, right now

the costs of the District's control regime — and its corresponding benefits to some tenants — are probably as low as they have been in many years.

If the District forgoes the opportunity to reform rent control and regulations that impede new investment in rental housing while conditions are favorable, by the time the cycle turns and it becomes apparent controls are again binding, *either* the District's sitting tenants will have to bear the brunt of a costly and radical change in their situation if reform is undertaken at that time, *or* the District's potential new and newly formed households will bear the brunt of reduced availability of affordable housing if reform is delayed at that time.

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Appendix

Strategies for Terminating Rent Control in the District of Columbia

Strategies for Terminating Rent Control in the District of Columbia

Once the decision is made to end a rent control program, a variety of methods or strategies may be pursued to achieve that objective. On the completion of the initial scope of this impact study, the Authority asked Nathan Associates Inc. to prepare this appendix outlining the possible strategies that may be utilized to end the District's rent control program. The material presented here briefly outlines: (1) the various methods of de-controlling rents that may be applied by the District of Columbia, and their expected impacts, and (2) Nathan Associates' recommendations concerning which method or methods should be implemented by the District to end its rent control program. Of course the ultimate decisions on de-control must be taken by those charged with the political responsibility and authority to do so.

Nathan Associates recommends that the de-control strategy be *blanket-lifting with advanced notice*. We reached this conclusion after identifying options for de-control, and evaluating their relative merits given the District's situation. In addition, we note that whatever strategy is ultimately adopted, it is important that the reform be politically feasible and, therefore, credible. Continued concurrent reforms in other forms of housing regulation, and in the delivery of housing subsidies, can smooth the way for a more effective rent regulation reform.

De-control Strategies and Their Impacts

Rent controls have been studied more than any other housing market regulation, with the possible exception of zoning. As discussion and argument about the effects of different kinds of controls have dominated the debate, it is not surprising that less is known or has even been conjectured about different ways of eliminating or relaxing controls. Comparative static models of the implementation of rent control provide little guidance on how best to eliminate rent controls.[70] By their *static* nature,

[70] The supply and demand model of the rental housing market described in Chapter 3 of this report (p. 28) and the more complex 4 Quadrant Model of the property and investment markets described in Chapter 4 (pp. 67-73) are comparative static models.

rent control models imply that immediate and complete blanket de-control works as well as any other possible strategy, a conclusion that should be treated with skepticism given the lack of knowledge of housing market dynamics in the event of de-control.

Typology of De-control Strategies

There are three broad categories of de-control strategies — *blanket-lifting*, *phase-out*, and *exemption* — each with a number of alternatives:

Blanket-lifting	*Phase-out*	*Exemption*
· Immediate · Advanced notice	· Vacancy de-control · Contracting out · Rent-level de-control · Floating up and out · Protected classes	· Vacancy-rate de-control · Rent-level de-control · Building-size or property-holdings de-control

Notice that the categories are not strictly mutually exclusive. Vacancy de-control and rent-level de-control are ways to both phase out controls and to relax controls that depend on exempting particular units.[71] A *phase-out* strategy with *protected classes* was used to end rent control in Massachusetts in 1996 while a *vacancy de-control phase-out* strategy has been in effect in Santa Monica, CA, since 1999.

Blanket-lifting De-control

Under *blanket-lifting*, all rent control provisions are completely eliminated by the stroke of the clock. *Immediate blanket-lifting* takes place suddenly and without notice. *Advanced notice blanket-lifting,* as the label implies, provides for all rent control provisions to be completely eliminated at a specified future date, after the affected parties are so notified.

Of course to some extent the difference between *immediate* and *advanced notice blanket-lifting* is a matter of degree. How soon is "immediate," and how long away is the date for which advanced notice is provided? Also, assuming *blanket-lifting* honors existing leases made under controls (as we

[71] These uses of vacancy de-control are not to be confused with vacancy de-control as a method for rent adjustments under an on-going rent control program. Some rent control regimes permit rents to be adjusted to market rates when a rental housing unit is available for lease; the unit again becomes subject to provisions of the rent control program when it is again tenant-occupied.

would suggest and the law may require), even "overnight" de-control will have different effects for units with leases up for renewal the next day, compared to leases not up for renewal for a year.[72]

Phase-out De-control

Phase-out strategies involve one or more means of reaching a complete elimination of rent control by stretching out the process over a period of time, permitting tenants and landlords alike the advanced notice to plan for the change.

Vacancy de-control provides for de-controlling rental units as they become vacant; thus, as long as the tenant continuously maintains occupancy in the unit it remains under rent control. *Contracting out* is a form of *vacancy de-control* whereby the landlord and the tenant negotiate a sum that the landlord pays to the tenant to end his or her controlled tenancy.

Rent-level de-control, which may be more appropriately termed de-control from the top down, involves de-controlling the most expensive units first and the least expensive last. The rent level above which units are de-controlled can depend on the location or type of unit. The utility of *rent-level de-control* as a phase-out strategy is predicated on the idea that if the threshold is fixed in nominal terms, as rents rise, more and more rental units will carry rents above the statutory ceiling for control and, thus, will no longer be subject to rent control.

Floating up and out is any de-control strategy that provides for a gradual relaxation of controls that applies uniformly across housing submarkets. When controls entail restrictions on the rate of rent increases, *floating up and out* permits a gradual increase in rents above the existing statutory limit. For example, if a jurisdiction permits rent increases at the rate of general inflation, *floating up and out* adds some increment to this allowable increase (for example, inflation plus 10 percent). When the control program contains a rate-of-return provision, this phase-out alternative permits a gradual increase in the rate-of-return above the statutory limit.

A *protected classes* strategy for phasing out rent control provides for extended rent control coverage for certain classes of renters — such as the elderly, the disabled, and those with low income — for a given period of time, and not for others. For example, rent control may end on a specific date for all except those who qualify for protected class membership, with rent control continuing to apply

[72] Treatment of the differing remaining lease terms of District residents of rent controlled properties will need to be resolved for any de-control strategy.

to protected class members who continuously occupy their rental units for the next several years.[73] This strategy may also take the form of a temporary or permanent rent subsidy for vulnerable tenants.

Exemption De-control

Exemptions are various means to limit the scope of rent control by exempting certain classes of renters, rental properties, or rental housing units from the provisions of the law.

Vacancy-rate de-control provides for the de-control of particular housing submarkets, defined on the basis of location or type of unit, with a vacancy rate above some statutory level.

Rent-level de-control as an exemption alternative calls for de-controlling specific housing submarkets based on the monthly rent for the housing unit. A common form of *rent-level de-control* is *luxury de-control*, a strategy used to target the benefits of rent control more closely to low- and moderate-income tenants rather than permitting benefits to be enjoyed by more affluent renters.

Building-size de-control, which is sometimes referred to as the *small property owner exemption*, excludes the applicability of rent control provisions to buildings under a certain size or to rental housing providers with holdings under a certain number of rental units.

Impacts of De-control Alternatives

The relative impacts of the varieties of de-control strategies are very much a function of their basic categorization and conditions in the market in which they could be applied, as well as the specific details and features of the mechanisms. One class, *exemption* strategies, has a number of disadvantages related to the mechanisms involved (that is, have some problems that remain important considerations no matter what the state of the housing market). We discuss this class first. Then we discuss the *blanket-lifting* and *phase-out* categories in tandem.

Impacts of Exemption Strategies

As a class, *exemption* strategies are alternatives for relaxing controls very selectively, and not their elimination. That is, this strategy typically leaves most housing under controls, with the same or sometimes increased administrative burdens. Therefore, *exemption* de-control strategies generally are

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[73] This is the de-control strategy adopted by Massachusetts for the elimination of rent control. See Chapter 3, p. 29.

not consistent with the regulatory reform for economic development imperative that is the impetus of this study of the District's rent control program. [74]

Further, each type of exemption strategy has its own disadvantage. A *vacancy de-control* strategy can produce perverse incentives for landlords to encourage tenants to move. *Rent level de-control* can lead to situations where landlords owning units with market rents somewhat below the threshold face an incentive to raise rent to the threshold, perhaps increasing the risk of a vacancy but ultimately resulting in a higher rent than would be found in an unconstrained market. *Building-size* or *property-holdings de-control* can also create perverse incentives for some types of investors, especially those "near the margin," (for example, if the threshold for property holdings de-control is 10 units, few landlords would invest in an 11^{th} unit).

For all these reasons we do not recommend any of the exemption strategies for the District of Columbia.

Impacts of Blanket-lifting and Phase-out Strategies

Whether *blanket-lifting* or *phase-out*, the ultimate long-term impact on tenants will be the same, namely de-control and movement to market rents. The exact magnitude of the impact will be determined for the most part by demand conditions in the rental housing market. Strong excess demand would result in significant long-run rent increases (and, if no other actions are taken, some tenant displacement) no matter which de-control strategy is implemented.

This study has concluded, however, that excess demand is *not* an appropriate characterization of the D.C. housing market for rent controlled accommodations, that the rental units at risk of an rent adjustment with de-control are a relatively small portion (17.3 percent) of rent stabilized housing units, and that the expected rent increases from de-control for occupants of *at risk* housing units are minimal. Among *blanket-lifting* and *phase-out* strategies, the specifics of alternative de-control strategies largely determine the timing of the impacts, which, while modest given current market conditions in the District, are not zero. These impacts are inevitable and cannot be eliminated by choosing one strategy over another (although they could be mitigated by other government actions). Differences among these methods have little effect on their ultimate long-run effects.

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[74] See Chapter 1, p. 5, for a discussion of the regulatory reform project carried out under the National Capital Revitalization and Self-government Improvement Act of 1997.

Two *phase-out* methods, *vacancy de-control* and *rent level de-control*, have already been discussed as *exemption* methods and their shortcomings are apparent from the discussion above. In some markets *vacancy de-control* as a de-control strategy has led to at least anecdotal reports of harassment and, at best, an uncomfortable misalignment of landlord and tenant interests.[75] The negative experience of tenants in other jurisdictions that have used vacancy de-control is not a development that anyone would want to be repeated in the District of Columbia. Another disadvantage of the *vacancy* and *rent-level* approaches to de-control is that their time path is quite uncertain. The uncertainty of the timing of the finality of market control associated with these options has the potential to cloud the clear message that the act of eliminating rent control should be sending to the rental housing development community. The uncertainty of timing could also retard or hamper the improvement of the District's competitive and comparative profile that could result from credible housing regulation reform.

Contracting out, essentially permitting a private bargain between landlord and tenant on the value of a controlled tenancy, and permitting tenants to in effect sell that right, has some appeal in theory but has some serious practical disadvantages. A common *contracting out* strategy permits the tenant to be free to accept payment from a landlord in order to vacate a unit, which is then let to a new tenant at market rent. That is, common strategies employing *contracting out* combine it with *vacancy de-control*. We have already argued that the negative experience of some tenants in other jurisdictions that have used vacancy de-control argues against this form. In effect, contracting out encourages landlords to encourage tenants to leave with a carrot (a payment) instead of a stick (harassment). Most landlords would prefer such an option for legal as well as ethical reasons, and it is certainly better for tenants. But it still encourages excessive churning of tenancies, and the time path of change is long and uncertain. The churning is an important consideration, because it is well documented that in all *uncontrolled* markets, the longer a tenant remains in place the lower their rent. Forcing "extra" moving about would reduce the availability of this discount to many tenants. In addition, the *contracting out* version of *vacancy de-control* implies that tenants have a property right in the rental accommodations that they occupy; a right that may be disputed in a number of venues. *Vacancy de-control with contracting out* could also result in additional administrative burdens for the

[75] As reported in Chapter 3. (p. 29), eliminating rent control by vacancy de-control in Santa Monica has been associated with incidents of tenants of rent controlled apartments being harassed by their landlords to end their occupancy.

District government and the property owners alike in settling differences of opinion in the value of that right.

Additional administrative burdens would also be associated with any *phase-out* option that is based on the idea of extended coverage for *protected classes* of tenants. Perversely, such regulations make the protected class less desirable as a tenant, when public policy presumably aims to encourage landlords to cater to such individuals and families. If a subsidy for lower-income and other vulnerable tenants is considered as a part of a rent de-control strategy for the District, it would be more economically efficient *and* more equitable to provide such subsidies through means other than rent control (such as in improvement in the District's delivery of housing subsidies, or even through the tax system).

For these reasons, we do not recommend *contracting out* or the declaration of *protected classes* as de-control strategies for the District.

We are left with three types of de-control: *immediate blanket-lifting, blanket-lifting with advanced notice,* and *floating up and out*. These three methods merit more serious consideration than those discussed to this point. Given the current state of the District's housing market, and the public and private administrative costs of rent control that do not benefit most tenants, ultimately we prefer *blanket-lifting with advanced notice*. But although we think that the arguments are strongest in favor of this method, the other two have some important advantages. We discuss each in turn.

Floating Up and Out

Floating up and out would be, in many respects, the preferred method in a "hot" market where blanket-lifting is too disruptive. Even in a "cool" market like the District's it retains some worthwhile features.

Floating up and out lends itself to a city with a rent control regime like the District's, where landlords and tenants are familiar with rent ceiling increases tied to a consumer price index. The same basic structure is kept in place and from a certain date forward, rent increases are permitted up to the rate of inflation in statutory index *plus* some additional percentage (say 10 percent as an example). Thus if inflation is 5 percent, allowable rent increases are 15 percent.

Units whose market rents are below the ceiling are unaffected. Those near the ceiling are effectively de-controlled, if a 15 percent increase *or less* brings them to market. Consider a unit whose controlled ceiling is initially, say, half of market rent. Such units are brought closer to market;

but while a 15 percent increase is substantial, the tenant does have some protection against an immediate doubling of rent. Of course in the next year (assuming annual leases) more ground will be made up. Eventually even the most stringently controlled unit is brought to market, but in a more gradual fashion than *blanket-lifting*.

Floating up and out would normally include a “sunset provision” that, in any case, any remaining rent controls would be eliminated at a stroke in some fixed period (say, 5 years). Otherwise, the administrative apparatus for controls must remain in place indefinitely, and these can be substantial burdens on the landlords and sometimes the tenants, as well as consuming substantial public financial and human resources.

Clear advantages of *floating up and out* are that it leads to eventual de-control, but provides a measure of protection against immediate sharp increases in rent. There is also the ability to determine just how fast one wants to float up; that is, what is the increment we add to the CPI adjustment? 5 percent? 10 percent? Even more? And when does the sunset provision kick in?

One disadvantage of *floating up and out*, relative to *immediate blanket-lifting*, is that it will keep the administrative burden in place longer, even though few tenants will benefit under the District's prevailing market conditions. Another is the flip side of the flexibility in choosing parameters for adjustment. These can be contentious. Who chooses the percentages, and should they speed adjustment or maximize tenant protection? Another disadvantage is that if ultimate de-control is delayed for several years, that not only sends a mixed message to investors, but invites changes in the reform agenda or even reversal before complete rent de-control is achieved, harming the credibility of reform.

Blanket-lifting: Immediate and with Advanced Notice

We would hesitate to recommend serious consideration of *blanket-lifting* in a "hot" market with controls strongly binding. However the District's rental housing market is characterized by high vacancy rates in some submarkets and market rents that are below the ceiling for most units. *Blanket-lifting* could therefore work well in the District.

Generally the advantages of *blanket-lifting*, whether *immediate* or with *advanced notice*, are: (1) it is simple and easy to understand, (2) because any negative effects such as rent increases are realized immediately, or at least when the next lease comes due, the costs are not drawn out, (3) there is no complicated administrative system to put in place to effect de-control, (4) the time path of

regulatory changes is clear and unambiguous for all parties concerned, and (5) not only are rents quickly returned to market for those below market (as noted, a minority of units in the District) but the existing administrative costs are quickly eliminated. A possible further advantage is that (6) a "clean break" would be less subject to modification in midstream, which we believe is important for the credibility and effectiveness of reforms. All in all, such a method of de-control sends a strong positive signal to potential housing investors.

Blanket-lifting has potential disadvantages. First, as alluded to above, *if* vacancies were low, market rents well above ceiling and rising, and the market generally "hot," *blanket-lifting* would lead to large increases in rents for some significant number of tenants. Many citizens would probably consider blanket removal of controls under such conditions as unfair and undesirable. Under the "hot" market scenario, it is also quite possible that *blanket-lifting* would actually be a less credible reform than other methods, in the sense that if rents were immediately de-controlled across the board, but many tenants experienced significant hardship that was unrelieved by other government or market response, controls could be re-imposed, perhaps even in a more stringent form. But as noted, these are *not* the conditions that presently prevail in the District.

Even in a "cool" market like the District's current one, with most unit ceilings above market rents, there is no doubt there would be some increases, and somewhere there would be sharp increases. We believe that many people, including those who would bear such costs, would consider a de-control option that gave some time for adjustment more fairly than one which was immediate and perhaps in many quarters unexpected. Thus, an argument in favor of *advanced notice* over *immediate blanket-lifting* is that we believe many citizens will consider it fairer, and it will give any tenants who are adversely affected more time to adjust, both psychologically and economically. Arguments in favor of *immediate blanket-lifting* are that administrative costs are lessened sooner, and there is a lower probability that during the period of de-control changes would be put forward that reduced the credibility of reform.

De-control Strategy Recommended for the District of Columbia

The appropriate de-control strategy for ending the District’s rent control program must strike an effective balance among multiple constraints and objectives. As discussed in the concluding section of this report, the expected level and incidence of impacts of de-control on tenants are at a minimum at present. The principal constraints and objectives are that:

- Postponing de-control with an extended transition period could very well result in greater and more widespread impacts on tenants at the end of the transition period.
- The business community needs the assurance that rent control will end at some point in the near term; an unambiguous signal to landlords that rent control will end permanently will maximize the potential for new investment.
- Tenants and landlords alike need advanced notice of rent de-control to plan.
- The reform should be understandable, fair, and credible. Initial de-control in a manner judged arbitrary or unfair by many citizens will be followed by re-control and helps no one.
- While few tenants receive significant benefits from controls, the administrative costs are significant. It is important to reduce these as quickly as possible and eventually eliminate them.

These factors, and perhaps most importantly the current soft market for rental housing in the District, lead to our recommendation for a *blanket-lifting* of rent controls with *advanced notice*. Although the overall tenant impacts of eliminating rent control are expected to be minimal, and even though many occupants of rent stabilized housing units appear not to know whether or not the housing unit they occupy is subject to the rent control provisions of the District's Rental Housing Act, many will perceive a loss and the elimination of rent control will undoubtedly be a highly emotionally charged issue. The sense of loss, even though in most cases unfounded, that could accompany such an abrupt end to the District's rent control program requires the counterweight that a fair warning of the end of rent control provides.

We found that *blanket-lifting* (both types) and *floating up and out* were the strategies that deserved serious consideration. But finally, after considering the possible alternatives for ending rent control, their strengths and weaknesses, and their relevance in the District of Columbia context, Nathan Associates recommends that the de-control strategy be *blanket-lifting with advanced notice*.[76] Further, we recommend that the advanced notice period be the amount of time for current tenants to renew their leases one more time under the rent stabilization provisions of the Rental Housing Act; we expect that 12 to 18 months would be sufficient for this purpose.

A well designed de-control strategy will include collateral actions. The District's recent progress in streamlining permitting approvals is an example of the kind of regulatory reform that is important

[76] When considered in terms of tenant impacts alone, *blanket-lifting with advanced notice* is preferred to *floating up and out* or other soft landing methods for transitioning to an uncontrolled market. As explained here, complete de-control strategies differ principally in the timing of impacts. Any soft landing strategy would accelerate the inevitable impacts on tenants and, therefore, would not necessarily be in the tenants' immediate interests.

for its own sake; it will also help ensure a robust supply response, rather than creating undue pressure on rents, if and when the demand for rental housing in the District increases significantly. Careful consideration of other aspects of housing regulation, including landlord-tenant law,[77] would also be appropriate. There may also be opportunities for improving the delivery of housing subsidies targeted to households particularly at risk, economically and socially.[78]

[77] Rental Housing Act, Title IV (Landlord-Tenant Law).

[78] Such opportunities may include the HUD Section 8 housing assistance payments program.